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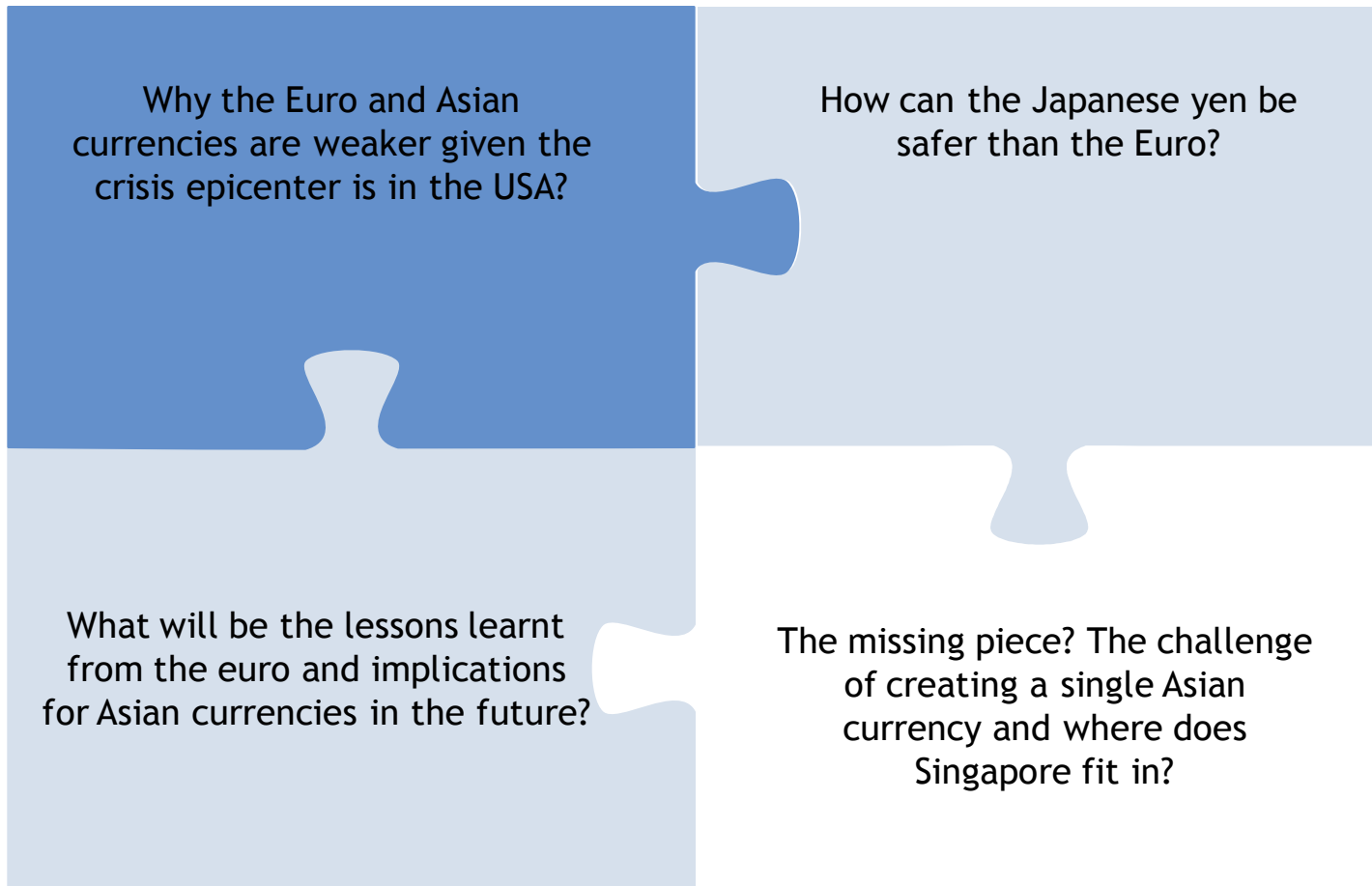
THE EURO AND ASIAN CURRENCY OUTLOOK AMID THE GLOBAL FINANCIAL TURMOIL

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Three key puzzles and a missing piece?

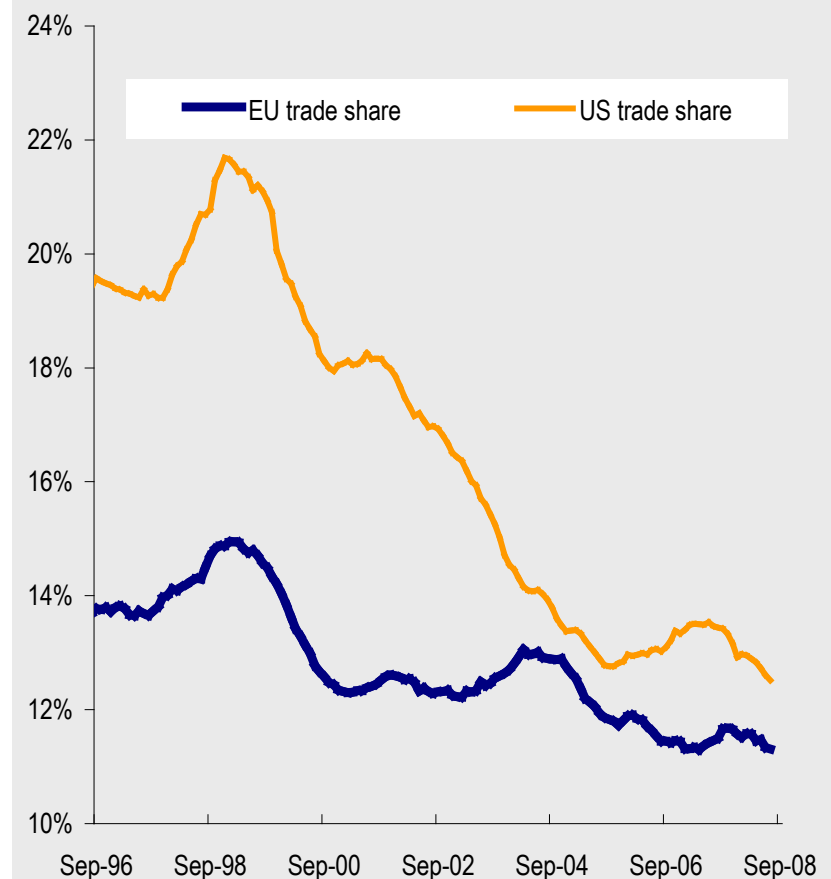


Why the Euro and Asian currencies are weaker given the crisis epicenter is in the USA?

Key points

- US recession signals a downturn to the global trade cycle which negatively impacts Asia and the Euro zone
- Financial distress and the dollar's dominance as a funding and transaction vehicle trumps current account deficit considerations
- Safe-haven status is a function of credibility, policy flexibility and depth of liquidity
- Euro already has a direct implication for Singapore by virtue of the Monetary Authority of Singapore's policy target of the trade-weighted exchange
- Euro weighting estimated at 11% of the MAS trade weighted basket

EU and US share of total Singapore trade

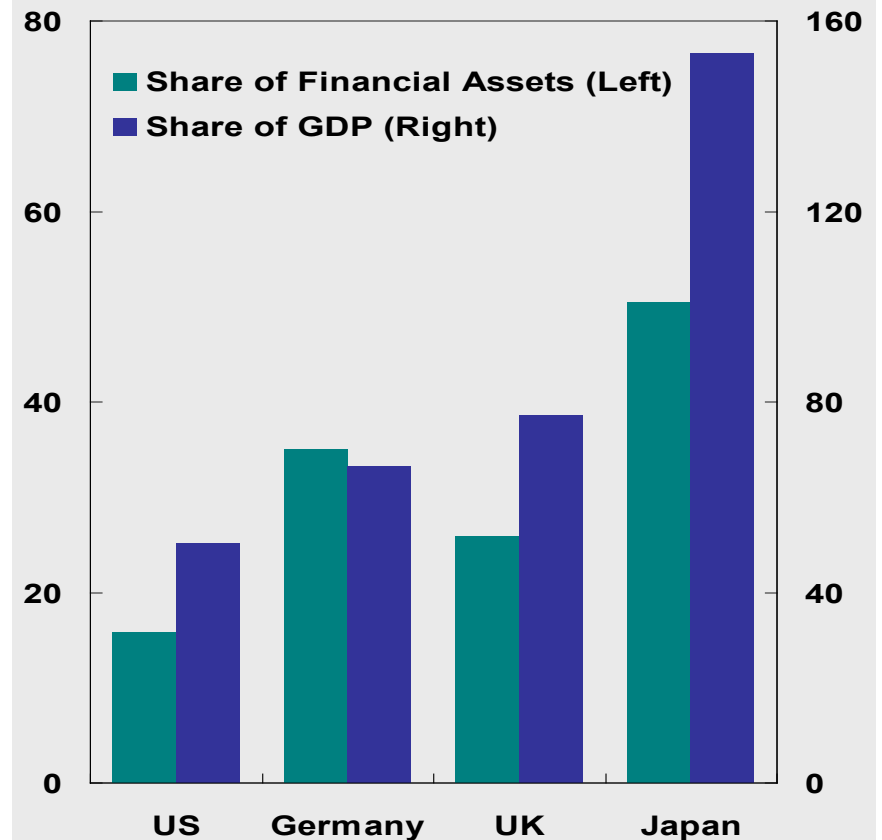


How can the Japanese yen be safer than the Euro?

Financial flows dominate trade flows

- The Japanese yen represents the most counter-cyclical currency among developed nations
- Key to this dynamic is Japan's status as the world's largest net creditor
- Over the past years, Japanese households have engaged in large scale overseas investments in search of higher returns and diversification
- In times of financial stress and widespread investor aversion to risk Japanese households repatriate their investments home
- The outcome is that the Japanese yen is negatively correlated with Asian currencies, the Euro and global equity markets

Household Cash and Liquid Deposits (Pct. of Household Financial Assets and Pct. Of GDP)



What will be the lessons learnt and the future role for Asian currencies and the Euro?

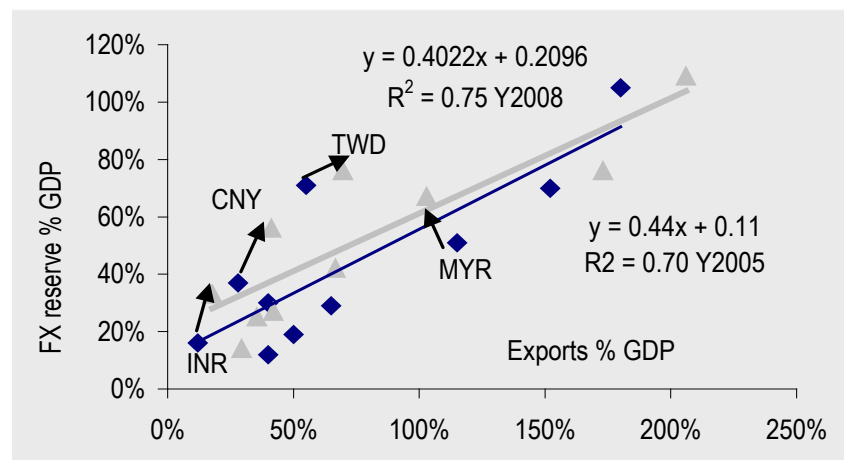
Lessons, solutions and risks

- Credibility still required for EUR & Asia FX
- Global policy coordination a necessity
- Over-dependency on USD is not healthy
- Possible solution? Asian single currency
 - Pool and reinforce credibility
 - Create better coordination and supervision
 - Build depth of the regional capital markets
 - Euro demonstrates that it is possible
- The risks
 - Protectionism
 - Capital control restrictions
 - Regionalization and second best solutions

The lessons learnt from the Asia crisis - An intermediate solution

- Managed floating exchange rates are better
- FX reserves provide insurance
- ...yet fear of floating remains
- ...deep domestic bond market required
- Euro proved to be an asset

FX reserve accumulation closely related to export openness

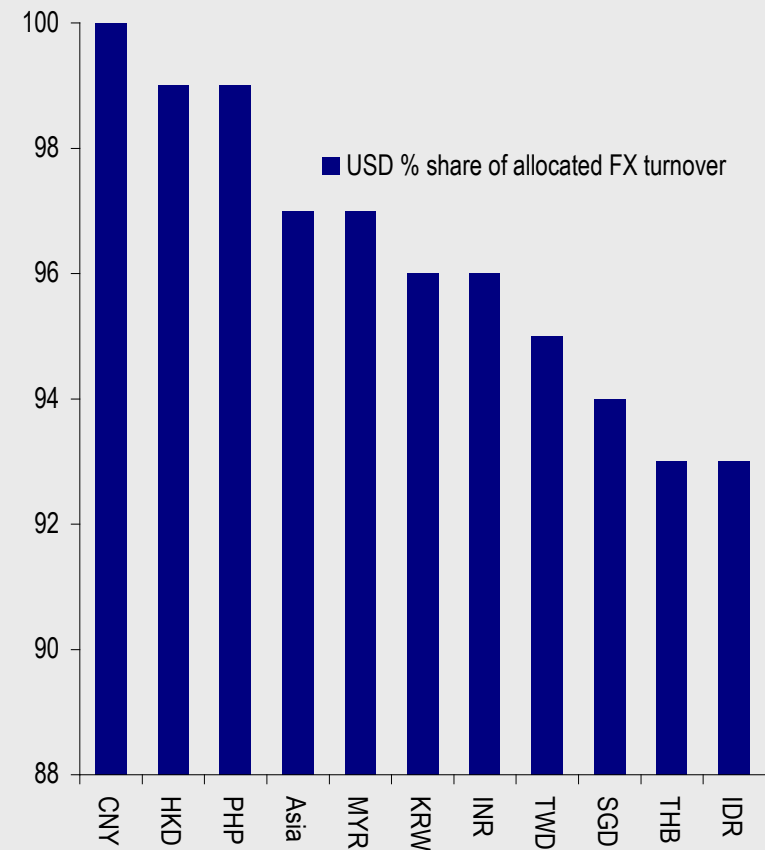


The missing piece?

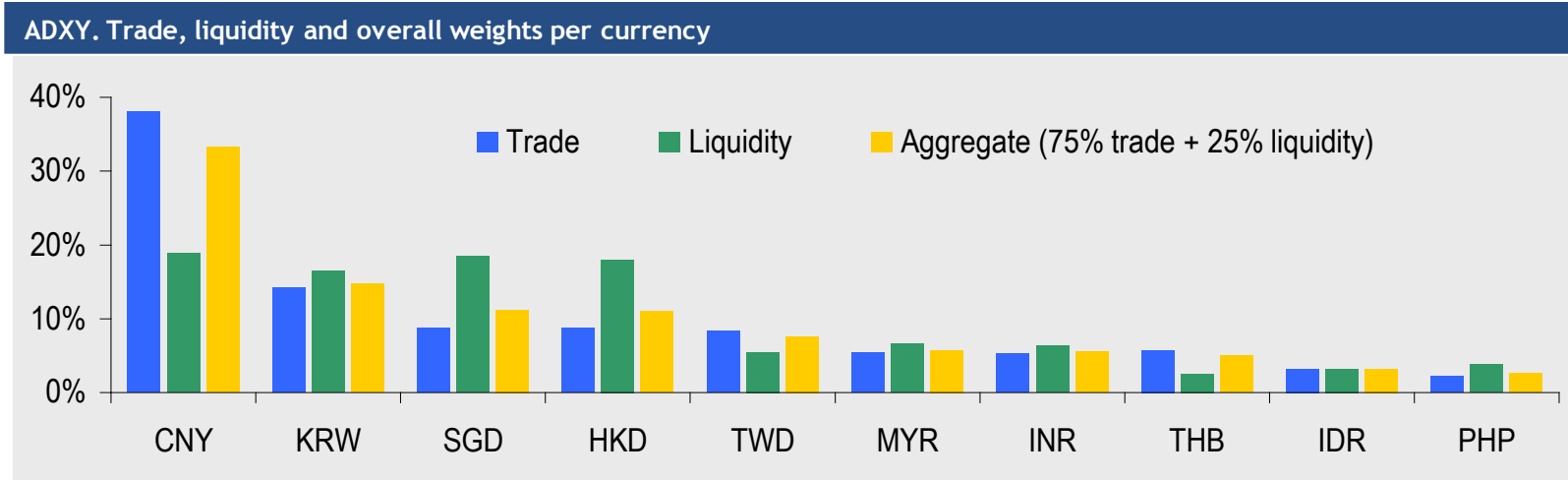
Single Asian Currency

- Asia is far too USD dependent for a region that is increasingly intra-regional in trade terms
- The absence of credible FX stability, basic hedging derivatives and reduced capital restrictions remains an impediment to capital markets growth
- A single currency would help to foster less reliance on USD as a vehicle currency, “externalize” some of the hedging costs and funding risks to others and facility less dependency on foreign portfolio flows for investments
- The challenges are considerable, but how would a possible Asian currency look like?

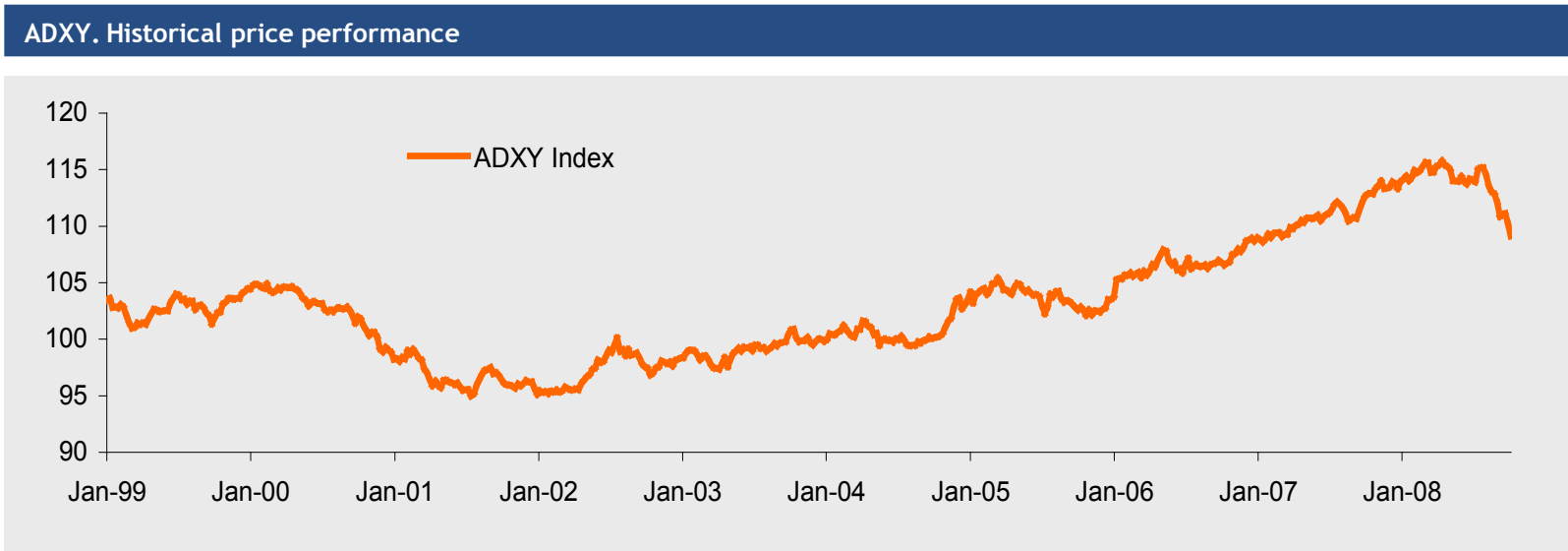
Foreign exchange turnover by currency pair



JPMorgan's ADXY weights and historical performance



Source: Bloomberg ADXY <go>



Source: Bloomberg ADXY <go>

China and India are already eroding their USD peg link

Rolling regressions of weekly changes in INR and CNY against USD and other major currencies reveals gradual move to FX independence

- Regressing weekly changes of CNY and INR against changes in EUR, JPY and USD shows that USD remains the dominant soft peg. However, this USD peg which stood at 100% in 2000 now stands at 90% as a proportion of currency basket peg.
- Perhaps, more importantly, there is no other G7 alternative peg to USD. Regression coefficients for JPY, GBP and even AUD are volatile and not robust. The longer term implication is that Asia FX is emerging as an independent currency block.

