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Internationalization of the Yen in an "Asia First" Way

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The Ministry of Finance released on June 12 a document distributed at the sub-committee of its Council on Customs, Tariff, Foreign Exchange and Other Transactions. The document highlighted three areas as the medium-to-long term issues to be tackled to further enhance the user-friendliness of the Japanese Yen against other Asian currencies: namely, (1) further permeating of the yen in Asia, (2) expansion of direct currency exchange market between the yen and other Asian currencies, and (3) study of multicurrency settlements in Tokyo market. These efforts constitute a part of its policy of "Strengthening of International Financial Infrastructure in Asia as a Growth Strategy", and the document emphasizes the need to enhance the user-friendliness of the Yen in Asia as well as to improve financial infrastructure in a medium-to-long term perspective so that it will help Japanese companies to be able to use Asian currencies more easily in Japan. According to media reports delivered in tandem with the issuance of this document, "expansion of a direct exchange market" noted in above (2) is likely to be addressed at the first onset. In order to expand the usage of the yen and other Asian currencies, an initiative has been announced for establishing a market where the yen and other Asian currencies can be directly exchanged without intermediation of the US dollar, through which the yen settlement network will be expanded to Asia. It is reported that at first Japan will enter into consultation with Thai government to promote a direct exchange between the yen and the Thai baht.

Although it is not clearly mentioned, current attempt may be said to be a renewed effort of Japan's long standing policy measure to "internationalize the yen." Originally the "Internationalization of the Yen" was included in a report by the US-Japan Yen Dollar Committee which was held in the days the Japanese economy gained power in the 1980s, and it started from the proposals made in the spring of 1984 by the US members for Japan's opening of financial markets. Later in the volatile fluctuations of foreign exchange rates with basic trend toward appreciation of the yen following the Plaza Accord, the internationalization of the yen turned into a stronger initiative on the Japanese side that aims to mainly alleviate the foreign exchange risks on the Japanese companies. To borrow from a trendy expression, the deregulation and liberalization measures of Tokyo market started with the “America First” proposals and were later translated into “Japan First” measures like facilitation of Euro-yen market and establishment of Tokyo Offshore market, and now they are going to be promoted anew as an “Asia First” effort after experiencing the “Japan’s Financial Big Bang” that took place in the latter half of the 1990s.

To put it more simply, the internationalization of the yen means an effort aiming at “making the Japanese yen more frequently and globally used currency”. In the backdrop that the policy emerged anew in the “Asia First” framework, there seems not only the challenges in Japan’s growth strategy that its government seeks, but also the necessity of emerging Asian countries which want to promote “breakaway from heavy US dollar dependency in their economic activities”. Looking on a macro base, many emerging countries still depend heavily on the dollar as is seen in their continued holding of a high level of dollar-denominated borrowings. Understandably they may have a strong wish to be freed from a situation where they have to struggle to secure a sufficient liquidity or stabilize their home currencies against a concerned capital outflow every time the US Federal Reserve tightens its monetary policies. In fact, in Indonesia and Malaysia, the governments are promoting mandate use of home currencies in the domestic transactions and settlements and in Thailand and Malaysia they have announced a framework to promote settlements of bilateral trades in their own currencies. The move toward reduction of dollar dependency in Asia is slowly but steadily materializing.

With the development of such a move, it is expected that the demand for Asian currencies by the Japanese firms and financial institutions will further increase. However, in the actual foreign exchange markets, a great deal of exchange transactions are still mediated by the dollar as is shown in the fact that almost 95% of the Chinese yuan(RMB) transactions were conducted against the US dollar (for details see “What's Behind the BIS Triennial Foreign Exchange Survey in 2016” and others). If a market for direct exchange between the yen and other Asian currencies should be expanded, the Japanese companies will be able to enjoy a reduced cost for their exchange transactions and improved financial efficiency through settling in the yen, while Asian companies will be able to expect more stabilized liquidity management. Thus the “internationalization of the yen in an Asia First way” will prove to be a win-win measure for both Japan and other Asian countries.

Attempts to make the yen more usable currency in trade payment and international finance have been made in a various ways thus far. Whereas the former initiatives for the internationalization of the yen gave an impression that it was promoted at a macro level of how to enhance the status of the yen within the key currency system depending on the dollar, the present initiative can be characterized as the one of a micro aspect which brought to the fore by recognizing the yen as a sole hard currency in Asia, and its role of “one of the most important financial infrastructures” and then aiming to increase yen’s user-friendliness. For instance, the direct exchange between the yen and Thai baht is institutionally possible even today, but practically it is hard to promote it. In this regard, the both governments are trying to find out possible constraints, with the Japanese government promoting improvement of its settlement system while the Thai government promoting deregulations and the like. Incidentally, the operating hours of the "BOJ-NET" (a settlement system the Bank of Japan operates) was extended in December 2016 to 21 o'clock, enabling it to cover the whole daytime in almost all Asian regions and overlap the morning business hours in Europe.

In the background that the transactions in yen do not actually increase albeit it is institutionally possible, there is a "wall" of the dollar as a dominant key currency. A currency has following three functions: ①unit of account, ②medium of exchange and ③storage of value. An international currency is the one that performs well in these three functions and, needless to say, the biggest existence is the dollar which has reigned over the financial world as a key currency. Specifically the strong "network externality" that is working on the above ① and ② functions has made the position of the dollar firmer. In other words, with most of the market participants expressing the value of international transactions in US dollar and using it as a medium of exchange and settlement, a situation has been created where its benefit has been synergistically penetrated only to make the transactions concentrate into dollar. All in all, will the Japanese yen be able to transform to such a currency, at least in Asia, comparable to the dollar which has the most stable and efficient trading infrastructure built up over the years? Much is hoped for the 21st century-version of the "Internationalization of the Yen in an Asia First way" that improves user friendliness flourished on a win-win relationship in a micro perspective.