

FORMING A SINGLE CURRENCY IN ASEAN COUNTRIES:  
A VAR ANALYSIS



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## **5. Report**

### **5.1 Proposed Executive Summary**

Since the introduction of a single European currency, the Euro, in January 1999, there has been much interest in the area of Optimal and Common Currency areas. Relying on views by Mundell's (1961) has defined that Optimum Currency Area (OCA) is a domain within which exchange rates are fixed. By this definition, a OCA would be a step further with the adoption of a single common currency among members of the currency union and viewed as a palatable solution for global economic crises.

This empirical study purposely is to analyze the possibility of a currency union/ single currency among ASEAN countries. The study is designed to address the following question; (i) Is a currency union a feasible for ASEAN countries? (ii) What would the costs and benefits of such an arrangement be? The key criterion in determining the possibility of OCA is relying on symmetry of economic activity for each individual country, which our analysis is built on identifying compatibility among our sample country in ASEAN. Since compatibility would imply some degree of synchronicity among key macroeconomic variables, we examine macroeconomic data. Specifically, we examine annual data on real GDP growth rate and inflation rates across 5 countries, consists of Malaysia, Indonesia, Singapore, Philippines and Thailand over the 20 years period 1989 – 2008. Our choice of these variables has to do with the fact that aside from synchronous business cycles, similar levels of inflation and a degree of policy congruence have been cited as necessary preconditions in previous literature.

In indentifying compatibility, we use two analytical techniques. First, we carry out a series of correlation analysis for each variable across the sample countries. The Pearson Pairwise correlation statistic is used to check for statistical significance. The second analytical technique used is Vector Autoregression or VAR analysis. Both impulse response and variance decomposition is used to examine interrelationships among real GDP growth rate of the sample countries.



## **5.3 Introduction**

### **5.3.1 The Idea of Optimum Currency Area (OCA)**

The idea of this paper as title ‘Forming a Single Currency in ASEAN Countries by applying VAR Analysis’ is due to successful launch of the Euro in the early 1999 which make a common currency a particularly interesting option for region in ASEAN itself. More importantly, the recent regional financial crisis in ASEAN countries of 1997 has revealed vulnerabilities of exchange rate regime in the region. Furthermore, it has eroded the credibility of unilateral fixed exchange rate and correspondingly renewed calls for greater monetary integration and regional exchange rate stability in ASEAN. In addition, many researchers have advocated alternative exchange rate arrangement to enhance exchange rate stability. For instance, Williamson (1999) proposes a common basket peg among East Asian economies in his study. Meanwhile, Ogawa and Ito (2002) also advocate a basket peg to keep the real effective exchange rate stable. Beside, Kwan (1998) makes a proposal for formation of a yen bloc in East Asia and also McKinnon (2000) proposes to restore a dollar which based on exchange rate regime in East Asia while strengthening bank regulations.

### **5.3.2 Purpose of Study**

The main purpose of this empirical study is to analyze the possibility of a currency union/ single currency among ASEAN countries.

Somehow, as specifically the purpose of this study are as follow:

- i. To analyzing empirically on which country is feasible and suitable as candidate toward on currency union/ single currency among ASEAN countries.
- ii. To identify possible costs and benefits for those countries who suitable or not suitable on currency union/ single currency among ASEAN countries.