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# Research in International Business and Finance

journal homepage: [www.elsevier.com/locate/ribaf](http://www.elsevier.com/locate/ribaf)

Full length Article

## Fear of floating in Asia and the credibility of true floaters?

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### ARTICLE INFO

#### JEL classifications:

E42  
E58  
F31  
F33  
F41

#### Keywords:

Exchange rate regime  
Flexibility  
Fear of floating  
Asia  
Pegging

### ABSTRACT

Quite often, countries commit to free floating exchange rate (ER) regimes but do not allow their ERs to float freely, exhibiting a fear of floating. We revisit ER regimes in Asia following the work of Calvo and Reinhart (2002), and also develop a new flexibility index based on probabilities gauging interventions in FX market. In light of our findings, we cannot disregard the existence of fear of floating in Asia, and find that economies widely known as truly floating economies exhibit this fear too. Further, the results validate our concerns regarding the IMF's methodology of regime classification intermingling credible inflation targeting with fear of floating.

### 1. Introduction

In the 1990's, pegged exchange rate regimes were favored in emerging as well as developed economies,<sup>1</sup> as they offered benefits in the forms of stabilized domestic inflation, anchoring of agents' expectations to lower foreign inflation, discipline in policy making and escape from the time-inconsistency problem. Before the Asian Financial Crisis in 1997, many East Asian economies had their currencies pegged to the US Dollar. This collective policy was one of the major factors of the region's stability at the time (McKinnon and Schnabl, 2004). However, a fresh look at these countries shows a move towards the popular flexible exchange rate regimes, at least on *de jure* basis. Table 1 reports information regarding the *de facto* and *de jure* exchange rate policies in these Asian economics and their evolution over time.<sup>2</sup>

Exchange rate regimes in emerging economies have been widely investigated in the literature and it has been the view that apart from the benefits of exchange rate pegs, there are some costs associated with them in the forms of the loss of independent monetary policy, transmission of external shocks, speculative attacks and weakened accountability (Obstfeld and Rogoff, 1995). Additionally, such regimes are notorious for causing financial crises triggered by exchange rate crises when a peg breaks down (Mishkin, 1998). An

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**Table 1**  
Exchange Rate Regime's Classification in Asia.

Country	De Jure Regime	Official Stance and Authors' Comment	IMF Classification of De Facto Regime			
			2011	2012	2013	2014
<b>China</b>	Managed Floating	Announced on July 21, 2005 the Adoption of a managed floating exchange rate regime based on market supply and demand with reference to a basket of currencies.	Crawl-like Arrangement	Crawl-like Arrangement	Crawl-like Arrangement	Crawl-like Arrangement
<b>Hong Kong</b>	Pegged	Linked to US dollar (HK\$ 7.8 = 1 US\$) and maintained it by the operations of Currency Board System.	Currency board arrangement Stabilized Arrangement	Currency board arrangement Floating	Currency board arrangement Crawl-like Arrangement	Currency board arrangement Floating
<b>Indonesia</b>	Floating	The exchange rate is determined wholly by market forces. However, Bank Indonesia is able to take some actions to keep the exchange rate from undergoing excessive fluctuation.	Currency board arrangement Stabilized Arrangement	Currency board arrangement Floating	Currency board arrangement Crawl-like Arrangement	Currency board arrangement Floating
<b>India</b>	Managed Floating	Under the broad principles of careful monitoring and management of exchange rates with flexibility, without a fixed target or a pre announced target or a band.	Floating	Floating	Floating	Floating
<b>Korea</b>	Floating	The exchange rate is, in principal, decided by the interaction of market forces. However, the Bank of Korea implements smoothing operations to deal with abrupt swings in the exchange rate.	Floating	Floating	Floating	Floating
<b>Malaysia</b>	Managed Floating	On July 21, 2005, Malaysia adopted a managed float against a basket of currencies.	Other Managed Arrangement Floating	Other Managed Arrangement Floating	Other Managed Arrangement Floating	Other Managed Arrangement Floating
<b>Philippines</b>	Floating	The Bangko Sentral ng Philipinas (BSP) maintains a floating exchange rate system. Exchange rates are determined on the basis of supply and demand in the foreign exchange market. The role of the BSP in the foreign exchange market is principally to ensure orderly conditions in the market. The market-determination of the exchange rate is consistent with the Government's commitment to market-oriented reforms and outward-looking strategies of achieving competitiveness through price stability and efficiency. <sup>a</sup>	Other Managed Arrangement Floating	Other Managed Arrangement Floating	Other Managed Arrangement Floating	Other Managed Arrangement Floating
<b>Pakistan</b>	Floating	Pakistan has adopted the floating inter-bank exchange rate as the preferred option since 2001. SBP has attempted to maintain real effective exchange rate at a level that keeps the competitiveness of Pakistani exports intact. But, like other Central Banks, it does intervene from time to time to keep stability in the market and smooth excessive fluctuations (Husain, 2005). However in 2005 answering a question the Governor State Bank gave some policy stance that casted doubts on the true flexibility of country's exchange rate regime and were conflicting with the usual practice of free floating. <sup>b</sup> Monetary aggregate targeting where exchange rate is managed against a basket of currencies with undisclosed weights, is more like a "Basket, Band and Crawl or BBC managed float" <sup>c</sup>	Stabilized Arrangement	Floating	Floating	Other Managed Arrangement
<b>Singapore</b>	Managed Floating	In July 2, 1997, Thailand adopted the managed float regime where exchange rate is primarily determined by market forces and the Bank of Thailand could intervene only when necessary to prevent excessive volatilities.	Other Managed Arrangement Floating	Other Managed Arrangement Floating	Crawl-like Arrangement	Stabilized Arrangement
<b>Thailand</b>	Managed Floating		Floating	Floating	Floating	Floating

<sup>a</sup> Taken from the official website of Bangko Sentral Ng Philipinas <http://www.bsp.gov.ph/financial/forex.asp>.

<sup>b</sup> [http://www.map.org.pk/review/0205/rh\\_interview.htm](http://www.map.org.pk/review/0205/rh_interview.htm).

<sup>c</sup> <http://www.singapore-window.org/sw05/050723ft.htm>.

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