

Central Bank Co-Operation in Asia

Notes for talk by the Governor, Mr B. W. Fraser, to Asialink Group, Melbourne, 8 August 1996.

Introduction

I am pleased to have this opportunity to talk with you about a particular form of co-operation in the Asian region, namely co-operation among central bankers:

- in fact, we now have the beginnings of what could, in time, prove to be an interesting case study in regional central bank co-operation.

Asia and the World Economy

It is not surprising that so many people – central bankers included – should be interested in Asia these days:

- it makes up a substantial portion of the world economy, and constitutes the fastest growing market in the world;
- where you draw the boundary can be significant but, broadly defined, non-Japan Asia accounts for nearly a quarter (23 per cent) of the world's output, and Japan for a further 8 per cent; and

- non-Japan Asia has grown at an average rate of about 8 per cent a year over the past 15 years, about three times the average for industrial countries (2½ per cent).

Other indicators tell much the same story:

- non-Japan Asia accounts for about a fifth of world trade and Japan for a further 8 or 9 per cent;
- the East Asian countries alone are the recipients of about a quarter of global flows of foreign direct investment; and
- the financial markets of Japan, Hong Kong and Singapore represent 23 per cent of global foreign exchange turnover (April 1995).

Asian countries themselves have been quick to exploit these opportunities:

- intra-regional trade has been pivotal in their rising prosperity; and
- in 1994, 37 per cent of the total trade of non-Japan Asian countries occurred within that group of countries, up from 25 per cent a decade earlier.

Other countries are now seeking to get into the action:

- the share of OECD countries' trade with East Asia has doubled since the early 1980s;
- OECD countries source about 11 per cent of their imports from, and sell a similar proportion of their exports to, East Asia; and

- these ties are strongest with Japan and the United States – Europe's trade links are smaller, but growing rapidly.

Merchandise Trade with Non-Japan East Asia^(a)				
Per cent				
	Source of imports		Destination of exports	
	1982	1994	1982	1994
OECD	5.6	11.2	5.9	11.3
United States	11.2	20.2	9.9	15.7
Japan	13.3	27.2	18.8	35.2
Europe	2.5	5.7	2.0	5.2
Australia	10.5	13.5	13.2	26.1

(a) Comprises China, Taiwan, Hong Kong, Korea, Malaysia, Thailand and Singapore.

Australia is also in there in a substantial way:

- about 60 per cent of Australia's total exports go to Asia, 25 per cent to Japan, and 35 per cent to other Asian countries;
- in 1994/95, Australia had a current account surplus of about \$12 billion with Asia;
- Australia is Asia's fourth largest export market;
- these figures suggest a degree of engagement in Asia large enough for Australia to be viewed, rightly, as part of Asia;
- despite the strong trade links, the capital flows generally have been quite small, although the 'people' flows have been strong; and
- in 1994/95, 1.6 million Asian tourists visited Australia (22 per cent of all tourists came from Japan).

Central Bank Co-Operation

The broad thrust of these figures will be familiar enough to you:

- I mention them as a reminder of the dramatic rise of the Asian region on the global scene over the past decade or so;
- typically, this rise has been based on trade flows, and on capital flows which have augmented what were exceptionally strong saving ratios to begin with; and
- with half of the world's population, and living standards which still have a lot of catching up to do, the potential for further growth is enormous.

Various regional bodies have emerged to promote closer co-operation on trade and investment matters:

- these are the areas where the largest and most tangible economic benefits are to be made;
- ASEAN, for example, has evolved into its own free trade area, with an explicit timetable to eliminate tariffs within the group by 2003;
- the broader APEC forum seeks 'free and open trade and investment' among industrial member countries by 2010, and among developing members by 2020;
- the ADB has been promoting development in the region for about 30 years; and
- central bankers are sometimes involved in these particular regional bodies, but they are predominantly the preserve of Trade, Foreign Affairs and Finance Ministers.

Some longstanding arrangements for central bank co-operation in the Asian region do exist but these mostly have a training flavour about them:

- SEANZA and SEACEN are two prominent examples;
- for the most part, however, central bankers have tended to lag behind the mostly trade-related regional initiatives;
- perhaps they have been too pre-occupied with their domestic problems, or perhaps they have been content to leave co-operation in monetary and financial matters to multilateral bodies like the IMF.

Whatever the reasons in the past, that situation is now changing:

- advances in communications and IT

generally, combined with on-going financial deregulation, are creating truly global financial markets;

- these days, data releases and rumours in one market appear almost simultaneously in markets all around the world;
- regional markets for financial services are starting to function as if they were a virtual single market; and
- the functions of central banks, much more so than ministries, tend to be rooted in the financial markets.

Modern communications can transmit negative messages as effectively as they can positive messages, and these can cause instability in financial markets for what might sometimes be quite irrational reasons:

- Mexico's problems in late 1994/early 1995 are a recent case in point, and resulted in considerable volatility in the markets of Hong Kong, Thailand and some other Asian countries, although the 'fundamentals' in those countries were quite different from Mexico's;
- financial instability is obviously a threat to economic development, and domestic policies will always be the first line of defence in response to any such threat;
- but even sound domestic policies might not be sufficient in the face of big swings in short-term capital flows; and
- in this way, the liberalisation and globalisation of financial markets have heightened the international dimension of monetary policy making, and opened the way for greater co-operation among regional central banks.

A second strand to the changed situation has been a growing realisation that existing international institutional arrangements are not keeping up with these market developments:

- the IMF remains an important institution but it has the interests of over 180 member states to reconcile, and its capacity to respond quickly to volatile situations is questionable; and
- unless you are, say, a Mexico or Russia (and have powerful friends like the

United States and the major European countries), your troubles are likely to be less urgent in their deliberations.

And the BIS, the premier forum for consultation and co-operation among central bankers in western countries, has always had a distinctly European orientation:

- Australia is a shareholder in the BIS, as is Japan, but no other country in the region currently is (all but five of its 33 shareholders are central banks of European countries, and 13 of its 17 Board members are Europeans); and
- the BIS does a lot of things which are interesting and relevant to central banks, but it has been reluctant to recognise the changed weights of Europe and Asia in world economic affairs, despite concerted efforts on the part of its current General Manager.

There are, therefore, some strong and obvious reasons for promoting closer co-operation among Asian central banks at this time.

Proposal for an Asian BIS

It was against this background that I proposed last September that central banks in the Asian region should co-operate more closely with one another, perhaps modelling this co-operation broadly on what the BIS does (hence its shorthand description as a proposal for an 'Asian BIS'):

- the essential rationale was to provide a more focussed forum than presently exists in the region to help central banks cope with the emergence of deregulated, global financial markets and their consequences;
- the emphasis was very much on co-operation, not economic and political integration on the European model – neither an ERM nor an EMU have any relevance for Asian countries at this stage of their development; and
- the idea was that we would build on an existing regional grouping of central banks

and enhance co-operation in that framework, with the prospect of establishing a new regional institution in time, when the need for such a body had been demonstrated.

EMEAP appealed as the most appropriate grouping to begin with:

- EMEAP stands for Executives' Meeting of East Asia and Pacific Central Banks;
- this group grew out of an initiative by the Bank of Japan in 1991, and has been meeting twice a year over the past five years, usually at Deputy or Assistant Governor level; and
- the group comprises the central banks and monetary authorities of Australia, Indonesia, Japan, the Republic of Korea, Malaysia, New Zealand, the Philippines, Singapore, Thailand, the People's Republic of China and Hong Kong.

By any measure, its member countries make EMEAP a substantial group:

- compared with the European Union, for example, the population of EMEAP countries is more than four times as large; its GNP is 20 per cent larger; the growth rate is four times as rapid, the savings ratio is about double; and foreign exchange reserves are about one-third larger.

	EMEAP	European Union
Population (million)	1,725	371
GNP ^(a) – US\$ billion (1994)	8,174	6,728
– Average growth 1992-95 (%)	6.4	1.5
National saving ratio		
– Average (%)	32.7	18.8
Foreign exchange reserves		
– US\$ billion	546	402

(a) Calculated on the basis of purchasing power parity exchange rates.

As useful as past meetings have been, EMEAP does not have any policy development or operational functions.

- We have suggested four areas where

EMEAP central banks might co-operate more closely and develop some of their functions, namely:

- (i) Information and experience sharing on macroeconomic policy, particularly in the context of the challenge to maintain growth and control inflation in the face of rising and potentially volatile cross-border capital flows, and managed exchange rates (which they often are in Asian countries);
- (ii) similar information and experience sharing in the area of supervision of the banking and financial systems, in what is a diverse and rapidly changing environment in Asia. In time, this process could lead to a concerted 'Asian' input into the European-dominated BIS, which has been making most of the international running in these areas;
- (iii) the development of contingency plans to deal with crises, which might arise from shocks either inside or outside the region. These arrangements can range from information sharing and foreign exchange swap arrangements right through to a regional capacity to provide emergency support to participating central banks in exceptional circumstances; and
- (iv) the provision of reserves management and other central banking services to member central banks – something which the BIS currently does but which could easily be provided by a regional institution.

Results to Date

What then have been the reactions to this proposal over the past 10 or 11 months?

- the answer, in brief, is that 'encouraging' progress is being made.

There has been some predictable, but limited, muttering that this is not the way to go, that we should rely on multilateral bodies like the IMF and not seek to break the world into regional blocs:

- it is fair enough to ask whether, in an increasingly global world, there is room for regional bodies;
- I think there clearly is, and just as we pursue a three-pronged approach in other aspects of diplomacy without any embarrassment (that is, multilateral, regional and bilateral), we can do the same thing in respect of the central bank's international relations;
- provided their approaches are consistent with the sensible aims of multilateral institutions, regional bodies can actually help to reap the full benefits of more open goods and financial markets;
- I think they can help too with the sheer management task that is involved in promoting and monitoring global financial markets;
- a well prepared regional body might also have shorter response times in crisis situations, particularly in the case of smaller and/or less well connected countries; and
- an Asian BIS could, therefore, operate in ways which would complement the IMF and the BIS, not compete with them.

So far as the BIS itself is concerned, I think it is fair to say that the floating of this proposal sent a loud wake-up call to some members of that European-orientated body:

- it has probably strengthened the hand of the General Manager in his efforts to make the BIS genuinely more 'international';
- it is possible, consistent with those efforts, that some additional countries (including several from the Asian region) will be invited to become shareholders in the BIS;
- if this were to happen, it would increase Asia's representation on the BIS share register, although I am not sure it would do a lot more than that, at least in the short term; and

- it would not in itself do much to enhance co-operation among central banks in the Asian region.

Among EMEAP central banks, the reaction has been varied but generally positive:

- some were quite enthusiastic and keen to move quickly towards the establishment of new institutional arrangements;
- others wanted to proceed more cautiously, and enhance existing arrangements before establishing any new regional institution; and
- in one or two countries the involvement of other parts of the bureaucracy in what are typically central bank functions – such as management of foreign exchange reserves and bank supervision – has complicated matters.

Since the proposal was floated last September, various meetings of EMEAP representatives and working groups have been held to plot the path ahead:

- the preferred course to emerge from this process is to build gradually, rather than move immediately to establish any formal new institution; and
- three concrete developments are worth reporting.

First, and symbolic of the more co-operative spirit now emerging, a large number of bilateral repurchase agreements has been signed between EMEAP central banks over the past year:

- for its part, the Reserve Bank has signed agreements with the central banks of Hong Kong, Indonesia, Japan, Malaysia and Thailand;
- these repurchase agreements allow a participating central bank to raise funds by selling securities held as reserve assets to the other central banks, subject to an undertaking to repurchase the securities at some future date; and
- the repurchase agreements will enhance the liquidity available to central banks in times of need.

Second, a meeting of EMEAP Governors was held in Tokyo last month:

- this was the first time Governors of this group had met, even though representatives of EMEAP central banks have been meeting twice a year since 1991;
- the Governors agreed that they should meet at least once a year in future; and
- the meeting next year will be hosted by the People's Bank of China, a very enthusiastic supporter of closer central bank co-operation.

Third, the Governors agreed, on the basis of recommendations contained in a report from EMEAP officials, to establish three permanent working groups to study and report on various central bank functions:

- specifically,
 - (i) a working group on financial market developments – which will study the development of bond, money and foreign exchange markets, along with payment systems and other elements of financial infrastructure relevant to the promotion of these markets;
 - (ii) a working group on central bank operations – to look at various central banking services, but particularly the management of foreign exchange reserves held by central banks. It will also look at possible institutional developments. This group will be chaired by an officer of the Reserve Bank, and will hold its first meeting in Sydney next month; and
 - (iii) a study group on bank supervision – to upgrade and share information on bank supervision issues in the region. Among other things, this group will assess the policy and practical implications of adopting the standards of the BIS Committee on Supervision, and can be expected to develop a close working relationship with that Committee.

Conclusion

Given the way these things go and the obstacles that inevitably arise, I think there has been an encouraging degree of progress over the past year:

- things are moving, and solid foundations have been laid down on which a permanent structure of enhanced central bank co-operation might be built;
- certainly, a stock of goodwill exists which, in time, can wear down the hurdles which remain;
- it is now up to the various working groups which are about to get under way to develop practical proposals for closer co-operation;
- if these working groups can deliver benefits which outweigh the resource and other costs involved – which they obviously need to do if they are to lead anywhere – I would not be surprised to see an Asian BIS-type institution established in the next three to five years; and
- that might be no big deal to most of you in this audience but, provided it is well designed and implemented, I believe it could make a significant contribution to both regional and broader prosperity.

There is perhaps another, less obvious, more selfish reason why Australia should be promoting this kind of co-operation:

- as a middle-ranking country in a region of fast growing and potential economic heavyweights, we have to utilise our comparative advantage if we are to go on 'fighting above our weight' in international economic relations; and
- we do have a comparative advantage in many areas of central banking, and enhancing EMEAP and establishing an Asian BIS is one way of using our comparative advantage to help cement a secure role for Australia in our rapidly changing region.