

The Asian Crisis and the Reserve Bank

The Asian economic and financial crisis was the major single influence on the formulation of Australian macroeconomic policy in 1997/98. The ensuing declines in Asian exchange rates, domestic demand and imports were relatively quickly transmitted to the Australian economy. In the first instance, they affected financial markets, particularly the foreign exchange and equities markets. Shortly after, they showed up as falling exports, a widening current account deficit and a slowing in domestic demand. It is not the intention of this Report to provide a detailed analysis of the Asian crisis as that has already been done in various quarterly reports and speeches by the Governor and Deputy Governor. What follows is, instead, an account of what the crisis has meant for the Reserve Bank's activities over the past year, and the Bank's likely involvement over the coming year.

On the monetary policy front, the crisis has clearly had an influence on the Board's decisions and also on the staff's work in monitoring and forecasting economic developments. The Reserve Bank has taken a number of opportunities to spell out its views on the Asian crisis and on the implications for Australia. While it has been important to avoid alarmism, and to try to preserve community confidence in the economic environment, there were some inescapable consequences that needed to be drawn out. In particular, the community had to recognise that, even if economic policy, including monetary policy, was adjusted with perfect foresight, there was no way of avoiding some widening of the current account deficit, lowering of the exchange rate, and slowdown in economic activity and increase in inflation. In communicating these realities to the public, the Bank's two regular appearances before the House of Representatives Standing Committee on Financial Institutions and Public Administration were particularly useful.

As well as communicating to the Australian public its views about the effects of the Asian crisis, the Reserve Bank has also tried to play a direct role in Australia's efforts to help troubled Asian countries. The Bank was only one of the government entities involved, but through its role as both adviser and banker to government, its wide range of contacts among Asian central banks and its capacity to provide technical assistance directly to Asian countries, it was able to make a significant contribution, particularly when measured against the relatively small size of Australia in the international community. With central issues in the Asian crisis being the volatility of international capital flows, the fragility of financial sectors and the role of exchange rates, this has meant that much of the discussion concerned core central banking issues. The Reserve Bank was in a position to provide to the Australian Government relevant background

on the evolving crisis, and to participate actively in the international conferences and discussions leading to the major financing packages that were assembled.

The first of these packages was for Thailand. Following the escalation of the crisis in July 1997, the International Monetary Fund (IMF) convened a meeting in Tokyo early in August to canvass support. While most major countries participated in the meeting, the urgency and critical nature of the situation were most clearly perceived by countries of the region. Regional central banks, in particular, had been discussing these issues within the EMEAP forum. This helped the Tokyo meeting to agree promptly on pledges of support for Thailand amounting to around US\$17 billion – with US\$10 billion offered by countries of the Asian region. Reflecting the need to commit funds quickly, Australia's contribution of US\$1 billion was offered in the form of a central-bank-to-central-bank foreign currency swap. While this funding was provided by the Reserve Bank, it was always recognised that decisions of this nature – which involve a large international relations element – should properly be taken by the Australian Government, rather than by the Reserve Bank. In this case, the Cabinet approved the decision, subject to the Bank's agreement that its balance sheet could be used for this purpose.

As the contagion spread beyond Thailand, the IMF orchestrated subsequent support packages for South Korea and Indonesia. Australia committed up to US\$1 billion to each of these (Australia and Japan are the only countries to have participated in all three support packages). For the South Korean and Indonesian pledges, there was sufficient time to arrange provision for funding from the Budget, rather than from the balance sheet of the Reserve Bank.

Over recent years, the Reserve Bank has increased its involvement in international economic relations. For many years, it has participated in IMF and OECD meetings in a subsidiary role as part of the Australian delegation, and has been a member of the Bank for International Settlements (BIS) for three decades. But with Australia's growing involvement in Asia, the Reserve Bank has actively sought to foster ties with central banks of the region, principally through the EMEAP forum; it has also participated in activities relevant to central banking in the Asia-Pacific Economic Cooperation (APEC) forum, and has been ready to take part in regional conferences and training courses. The need for closer links between central banks follows the increasing international integration of financial markets. As noted, this trend was given a major fillip – and great immediacy – by the Asian crisis. Central banks of the region have worked together through EMEAP and, less formally, in bilateral contacts and through the variety of multilateral forums to try to understand the unfolding events, to discuss what collective action might be taken to mitigate the problems, and to devise appropriate responses for domestic policy-making. The Reserve Bank's participation in EMEAP is at its three levels – Governors' meetings (annual), Deputies' meetings (usually biannual, but more frequent over

the past year), and in the three Working Groups (for financial markets, payments systems, and banking supervision), which have each met two or three times over the past year.

At the multilateral level, there is a growing acceptance that the current international financial architecture needs to change. In recognition of the gradual shifts in global economic importance, greater representation has been given to Asia, Eastern Europe and Latin America. The Reserve Bank has participated in multilateral forums, most notably at the Meeting of Finance Ministers and Central Bank Governors (the “Willard Group”, also known as “the G22”) held in Washington in April, and in the Working Parties which have been set up to help define and develop the new international financial architecture. With the special emphasis of this effort focused on capital flows, external debt, information disclosure and prudential supervision, the Bank will have an ongoing role in these efforts to make international economic linkages work better. Also reflecting the need to widen its representation, the BIS (which added four east Asian members during 1996/97) recently opened a regional office in Hong Kong. As the BIS strives to become less eurocentric, the Reserve Bank has had the opportunity to participate in more of its activities.

Outside the central banking fraternity, similar efforts are under way, in concert with our Treasury colleagues. The two groups that had been established in earlier years – the Four Markets Group, comprising Australia, Hong Kong, Japan and Singapore, and the Six Markets Group, comprising China and the United States as well as the previous four – continued. During the year, a new broader group – the “Manila Framework” – was established. This group has a membership focused on Asian countries, with G7 countries also attending; it met three times during 1997/98, once in conjunction with the G7.

Given the extent of the problems in markets and institutions across the Asian region, the past year saw an increase in the frequency of Reserve Bank staff providing technical assistance, either bilaterally with our counterpart central banks, or as part of IMF Technical Assistance Missions. Most of the Bank’s technical assistance was focused on the Asia-Pacific region. The Bank seconded officers for short periods of time to the central banks of Indonesia, the Philippines and Thailand, covering issues of foreign exchange, bank supervision, accounting and management.

The Reserve Bank has participated in a variety of regional seminars and conferences – notably, with the South East Asian Central Banks (SEACEN) research and training programs. As usual, the Bank responded positively to requests from other central banks in the region to send some of their officers for technical discussions and training, including two two-month training programs for Chinese financial officers and shorter training programs for officers from the People’s Bank of China, Reserve Bank of Fiji, Bank of Papua New Guinea and Central Bank of Samoa. The Reserve Bank also provided assistance to the

National Reserve Bank of Tonga and the Reserve Bank of Vanuatu, to advise on banking supervision issues. During the past year, there were also two Reserve Bank officers on long-term assignment with central banks of the Pacific region, under arrangements with the IMF. Two other Bank officers have been on long-term attachments directly to the IMF.