

INTERNATIONAL FINANCIAL CO-OPERATION

While the Asian crisis is now some years behind us, its lessons continue to be reflected in the activities, debates and evolving institutional structures of the international community. Since 1997 and 1998, the nature of the debate has shifted somewhat, from initially trying to resolve crises and seeking to understand their causes, to now implementing programs and policies that might serve to reduce the likelihood or severity of future crises. Progress has not been made in all areas, as in some cases no simple solution has been identified, but the debate itself has broadened the general understanding of the issues.

Much of the implementation has fallen to the International Monetary Fund (IMF), by virtue of its central role in crisis management, its near universal membership, and its mandate for conducting country assessments. However, the establishment of the Financial Stability Forum and the Group of Twenty in 1999 has broadened the fora in which debate and co-operation on the critical issues can be progressed. The RBA has been active in both of these fora.

THE FINANCIAL STABILITY FORUM

Since its inception in 1999, the Financial Stability Forum has undertaken a series of investigations into issues of concern to international financial stability. Australia is represented on the Forum by the Governor, while other staff – from both the RBA and Treasury – have been involved in various working groups.

Highly Leveraged Institutions (HLIs)

One of the Forum's important initial tasks was to examine the implications of the operations of HLIs (predominantly hedge funds) for financial

stability and market dynamics. The Forum released the report of its Working Group on HLIs in early 2000 and, in March 2001, reviewed progress on implementation of the report's recommendations.

Perhaps the most significant element of the recent review's findings is that the structure of the hedge fund industry itself has shifted in a way that has reduced many of the previous concerns about their activities. Although the number of hedge funds has increased, their average size has decreased. In particular, many macro hedge funds – the funds considered to have caused the greatest market disruption in Asia during 1997 and 1998 – have either ceased operations entirely, or have been significantly scaled back. According to the review, this reflects “a reassessment of the risk-adjusted expected returns on large directional positions on asset prices” and “the industry perception that increased scrutiny of hedge fund investments would adversely affect potential returns”. The review also suggests that market discipline on hedge funds has increased and their overall leverage has fallen, reducing their capacity to disrupt markets. However, lower hedge fund activity has meant that liquidity in some of the markets in which they were previously active has been reduced.

Good progress has been made on some of the Forum's recommendations. Counterparty risk management practices – for example, standards of credit analysis and the level of senior management reporting of HLI exposures – have improved, as has regulatory oversight of HLI credit providers. In February 2001, a set of guidelines for foreign-exchange trading was launched with the support of 16 major commercial and investment banks in response to concerns about the effect of HLI positions on market dynamics.

These guidelines act as a benchmark against which market participants' behaviour can be judged, though they have no legal standing.

Another promising area has been the work of the Multidisciplinary Working Group on Enhanced Disclosure. This group, which worked closely with five major hedge funds and a range of other intermediaries, released its report in April. It recommended that HLLs be encouraged to disclose certain risk information on a routine basis to investors, creditors and counterparties and that consideration be given to regulatory measures if HLLs do not come to do so. Action has been left in the hands of the Multidisciplinary Working Group's sponsor organisations – the Basel Committee on Banking Supervision, the Committee on the Global Financial System, the International Association of Insurance Supervisors and the International Organisation of Securities Commissions.

The Forum also identified several areas where progress has been less encouraging. Efforts to introduce mandatory public disclosure by hedge funds have not made much ground. Legislation in the United States has been seen as critical to this push, but US authorities have been reconsidering the need for such a step. Further work is also needed on exposure measurement by counterparties to HLLs. While progress has been made in measurement of potential future credit exposure, efforts to introduce regular and comprehensive stress testing have progressed slowly.

Financial Standards

The Financial Stability Forum is also promoting adherence to international financial standards and codes in order to help make financial systems less crisis-prone. Work in this area began with the identification of 12 core financial standards by the

Forum's Task Force on the Implementation of Standards. More recently, a follow-up group has been raising awareness of financial standards and examining ways to encourage their implementation. The development of detailed methodologies and the encouragement of effective communication between standard-setting bodies have been positive steps. At present, the group is considering the feasibility of further supervisory and regulatory-type incentives, together with the provision of technical assistance to countries moving towards the adoption of new standards. Australia is represented on this group by Treasury.

Offshore Financial Centres

Another area on which the Financial Stability Forum has focused relates to offshore financial centres and their potential to undermine financial stability if inadequately supervised and if information flows between them and supervisors in other countries are insufficient. In May 2000, the Forum publicly identified a number of offshore centres that were considered to perform relatively poorly on the above criteria.

The focus of this work has now largely shifted to the IMF, which has undertaken to conduct or support assessments of offshore centres' adherence to relevant financial standards and codes. The RBA hosted an IMF outreach meeting for offshore centres in the Pacific region to initiate the program in September 2000. Many offshore centres have begun to take steps to enhance their supervisory, regulatory, co-operation and information practices and will now seek IMF assessments or undertake assisted self-assessments.

The Financial Stability Forum will undertake a stock-take of its recommendations in respect of offshore centres in September 2001.

THE GROUP OF TWENTY (G20)

Established in late 1999, the G20 brings together finance ministers and central bank governors from a cross-section of countries at different stages of economic development, along with the European Union, the IMF and the World Bank, for discussions on policies to promote sustainable and equitable economic growth. As well as the annual Ministerial meeting, which the Treasurer and the RBA Governor attend, Deputies' meetings of central bank and finance officials are held twice-yearly.

Since its formation, the G20 has devoted a significant amount of time to examining ways to reduce the frequency and severity of financial crises. At the annual meeting in Montreal in October 2000, Ministers and Governors developed a consensus on appropriate policies which, considered together, would reduce economies' vulnerability to financial crises and also provide an appropriate framework to deal with such an event. The policy agenda seeks to strengthen the international financial system and domestic financial structures in a number of areas: the selection of appropriate exchange rate arrangements, prudent liability management, implementation of international standards and codes, and the development of a workable framework for involving the private sector in the prevention and resolution of financial crises.

In recognition of the trend towards greater international integration of economies and markets, the G20 agenda was extended in Montreal to include discussions on the opportunities and challenges posed by the process of globalisation. Ministers and Governors agreed on the importance of developing policies to ensure that the benefits of globalisation are

maximised and shared as widely as possible. Members noted that, while globalisation can produce enormous benefits in raising living standards, there is the real possibility that some societies may experience dislocations during the adjustment phase. The G20 has sought to broaden the globalisation debate – balancing discussions on the benefits of market-based reforms with recognition of the social and human dimensions of economic change.

The current G20 work program aims to develop a deeper insight into the globalisation process. Member countries have agreed to undertake case studies reviewing experiences with globalisation – not only instances where market reforms have brought about clear improvements in economic welfare, but also where the process has been more problematic.

REGIONAL GROUPS

Over the past decade, the RBA has developed strong links with other central banks in the Asian region, both bilaterally and through various regional organisations. The main such organisation for regional central banks is the Executives' Meeting of East Asia-Pacific central banks (EMEAP). This Group brings together central bank officials at various levels, including an annual meeting of Governors. The RBA hosted the annual meeting of Governors in Sydney in July 2001.

After the Asian crisis in the late 1990s, it became clear that central banks from this region were under-represented in international policy discussions. The formation of the Financial Stability Forum and the G20 redressed this to some extent. Four of the 11 central banks on the Financial Stability Forum are from the region, while six regional countries are represented on G20.

Two further steps were taken during the past year to better integrate regional central banks into international discussions. The first was the creation of the Bank for International Settlements (BIS) Asian Consultative Council, which held its first meeting in Basel in June, in conjunction with the Annual Meeting of the BIS. The Council includes central banks from Australia, China, Hong Kong, India, Indonesia, Japan, Korea, Malaysia, Singapore and Thailand. The central banks of New Zealand and the Philippines, which are not members of the BIS, will also be invited to future meetings. The Council will provide advice to the BIS Board on a range of regional issues, including the activities of BIS in Asia, particularly through its Representative Office in Hong Kong. The RBA Governor is the inaugural chairman of the Council.

A second significant event for central banks in the region has been the instigation of regular meetings between EMEAP central banks, the New York Federal Reserve, the European Central Bank and the G10 Committee of Experts on Gold and Foreign Exchange, to discuss developments in global and regional foreign exchange markets. The gathering, now known as the EMEAP Forum on Foreign Exchange Markets, was first held in early 2000, and will convene twice a year. The RBA's Head of International Department is the chairman of the Forum.

OTHER GROUPS

The RBA is active in a number of other groups related to the BIS and G10. Two of these are the G10 Committee on the Global Financial System (CGFS) and the Committee of Experts on Gold and Foreign Exchange, which meet several times a year. These discuss a range of international financial issues and monitor global markets. In addition to taking part in the regular meetings of

these groups, the RBA participated in a CGFS working group on *The Implications of Electronic Trading in Financial Markets*, which reported in January 2001. The group found that electronic trading is rapidly gaining ground in fixed-interest markets, having already become the dominant trading medium in the inter-dealer foreign exchange market. The group noted its impact on market structure, particularly the diminishing role of voice-brokering and direct dealing between dealers, and found that the relative cost-effectiveness of electronic trading has yet to be fully realised in most markets. The group also raised several issues concerning the potential impact of electronic trading on financial stability, noting that there was still no consensus on the impact of electronic trading on the liquidity and the resilience of a market.

Another G10-related group to which the RBA contributes is the Committee on Payment and Settlement Systems (CPSS). As part of the work of this Committee, the RBA was represented on a group that prepared the report on *Core Principles for Systemically Important Payment Systems* in January 2001. The *Core Principles* codify good practice in the design of high-value payment systems and draw on experience in reform of payment systems over recent years. Because the Australian dollar is one of the seven currencies to be included in initial operations of the "continuous linked settlement" or CLS Bank, the RBA is a member of a CPSS group co-ordinating central bank oversight of the project and liaising with CLS Bank on a range of operational and policy issues. The CPSS has recently begun to focus on retail payments and, reflecting its role in promoting the efficiency of Australia's retail payments system, the RBA was invited to join a



SIXTH EAST ASIA AND PACIFIC (EMEAP) GOVERNORS' MEETING, HOSTED BY THE RBA IN SYDNEY, JULY 2001.

group working on these issues. In the past year, this group has published a report on the clearing and settlement of retail payments.

TECHNICAL ASSISTANCE

Central banks in many developing economies have continued to adapt and broaden their operations in the wake of the late 1990s crises. Many have sought assistance to bring these changes about. The RBA has been willing to play its part in this process and has responded favourably to all direct requests received from central banks during the past year.

Help was provided by allowing staff from other central banks visiting Sydney to see how the RBA undertakes various tasks. During 2000/01, there were 10 such visits by staff of central banks in the region. The main interests of visitors were

financial market operations, economic analysis, note issue, accounting and auditing.

Some assistance is more efficiently provided on the ground in the country concerned, and the RBA has stood ready to help where possible. To this end, one staff member has continued to work full-time in providing technical assistance to the Bank of Papua New Guinea, while another undertook a short-term project on liquidity forecasting and market operations. Others have made short-term technical assistance visits to Samoa and Tonga.

Staff were also made available to assist regional and international organisations to help in the training process. One staff member assisted on an IMF mission to Thailand, while another developed and organised technical assistance programs in

Samoa and Tonga on behalf of the Fund. Other staff helped present workshops in India, Samoa and Singapore on behalf of various organisations.

The issue of money laundering has also been high on the agenda of many countries and several international organisations this year. Australia is a member of the Asia/Pacific Group on Money Laundering which is undertaking a series of evaluations of the ability of regional centres to prevent money laundering. The RBA provided staff to assist in two of these evaluations in the past year.

FINANCIAL SUPPORT

From time to time the RBA provides bilateral financial support to countries in the region. In these cases, the RBA acts with the support of, or at the request of, the Commonwealth Government. Such financial arrangements are provided on commercial terms and are therefore at no cost to the RBA.

In 1997, the RBA entered into a foreign exchange swap facility for up to US\$1 000 million

with the Bank of Thailand, as part of a US\$17 billion IMF-led financing package. Improving economic conditions in Thailand through the late 1990s meant that only US\$862 million of the facility was drawn down, the last drawing occurring in mid 1999. From March 2001, the Bank of Thailand began repaying the swap as scheduled. By the end of the financial year, US\$712 million of the facility remained outstanding.

CO-ORDINATION WITH OTHER GOVERNMENT AGENCIES

The RBA also participates with several Commonwealth Government departments and agencies to formulate Australia's international economic policy. These organisations include the Department of Foreign Affairs and Trade, Treasury and AusAID. This work is co-ordinated through the International Economic Policy Group, which is chaired by the Department of Prime Minister and Cabinet and meets about eight times a year.