ECONOMIC SOCIETY - 30 OCTOBER 2000

TRANSCRIPT OF QUESTION AND ANSWER SESSION FOLLOWING TALK BY RESERVE BANK DEPUTY GOVERNOR, MR SA GRENVILLE TO ECONOMIC SOCIETY OF AUSTRALIA (NSW BRANCH) - 30 OCTOBER 2000

[Because of limitations in audio recording, the questions transcribed below are not verbatim, but are paraphrased only. Similarly, names of questioners may not be accurate; we apologise for any errors.]

Nigel Stapledon, Westpac: Steven, would the Singapore model have worked in the case of Indonesia? It may have worked in Singapore because the Singapore dollar is so strong, but would the model have worked in Indonesia?

Mr Grenville: It's a good question and I am not sure I can give the answer. I think clearly that the problems of Indonesia were much, much more serious than the challenges which Singapore faced. And of course Singapore has a long history of excellent administration, so it's not clear that simple application of that to other countries would have stopped the crisis. I think the answer has to be it's rather doubtful. My guess is that these countries would have been better off if they had had the Singapore model in their mind to start with and it had been in place for some years before the crisis. But it couldn't have been applied at the last minute to save the crisis.

Grant Wilson, **BT Funds Management**: Do you have any suggestions on how emerging market countries can make the transition to a different exchange rate regime without actually causing a crisis?

Mr Grenville: Again, another very good and interesting question. I think we all had problems during that transition. If you remember the transition in Australia it wasn't an easy period. We didn't have a crisis of the magnitude of the Asian countries but is was a very uncomfortable period as we all got used to the idea of working with very free markets. I recall in the speech I refer to the pressure when the Reserve Bank, for instance, tried to introduce or did introduce prudential supervisory rules, necessary as we now know for the sort of free market that we moved to, there was quite a clear voice coming from people who were accusing us of regulation by the back door.

And so there is always pressure that stops governments, slows governments down from introducing what you might call the rules of the game which are necessary in free markets. We know that free markets are not free in the way a seagull is free. Free markets are surrounded by all sorts of rules and regulations which make them work properly. And putting those in place is difficult because some people will oppose it and more to the point I suppose is takes time. How long does it take to set up a good prudential regime? Ten years? Longer? How long does it take to put in place good corporate governance that's suitable for that particular regime? Quite a bit of time is probably the answer.

So, I'm coming at this a bit indirectly in saying that I think all countries had difficulties of one kind or another as they went through that process of deregulation. Could countries do something about it? Well I think the first thing to realise is, if you like, learn the lessons from Australia that you shouldn't allow yourself to be intimidated by those who say "Oh well, this is re-regulation; this is re-regulation by the back door". You should step boldly into what I call in the speech "intrusive prudential supervision" when that's necessary. I think you see a series of problems with foreign currency loans, those taken out directly by private non-bank individuals with foreigners and those that came via banking systems. They both caused problems in Thailand and in Indonesia. Now more intrusive, more boldly, intrusive prudential supervision might have helped to handle that problem. I think there's at least a hint in the talk here too that some efforts to slow down the capital inflow might also have happened because I think when you get big regime shifts you get large capital flows shifting and that's just extremely difficult to handle. 13% of GDP inflow in a single year, who can handle that?

Alex Erskine, Erskinomics: How does an emerging markets central bank decide that movements have gone beyond reason? And secondly, if there was a global currency, such as has been demonstrated by the European Union, how could Bangkok decide that its semi-floating exchange rate should have joined the floating global regime?

Mr Grenville: Well, on the first one, what's beyond reason? I think with an operational rule you have the comfort of having the feeling that, as I say in the talk, you can afford to let a rate go beyond what you think is sensible. And I think this is one of the lessons we should be trying to give to other people from our own experience. That you have to allow the market to take the exchange rate at times beyond what seems sensible. Now how far beyond is still a matter of judgment, but in a sense the further you get beyond what seems sensible the more pressure, the more justification there might be to act.

But more to the point, I suppose the greater chance of success because if you think it's gone much too far, much too far then maybe some other people in the market are also beginning to think it's gone much too far. So it's not a very specific answer. But I think operationally the important lesson to give from our own experience to other countries is to say that sometimes it will go beyond what seems sensible. You still let it go and you are always looking for the opportunity when your intervention is not only justified in the sense that you think it's gone too far but it's likely to succeed as well.

Now, global currencies and all of that, they seem to be a long way away to me so I think there's a lot of steps in the meantime I think the issues for the countries like Thailand will be much more whether to go with an "Asean plus three" sort of arrangement or even a yen kind of arrangement, rather than a world currency. Now even that set of issues is still some time away but at least it's on the agenda and all I can say is there will be vigorous consideration of those idea's of linking currencies, but on a smaller horizon than the whole of the world.

Kevin Maxwell, Bloomberg News: You said in your speech that "sometimes you just have to let it go". Is that your view of the Australia dollar at the moment.

Mr Grenville: It was worth a try! I think it's been said by the Treasurer and the Governor we're surprised the rates have gone this far. So in that sense, it is in that category but that says nothing beyond that. But let me try the same point another way., There are points in here about the behaviour of developed country exchange rates which are generalisations which the $A has experienced at some stage or another during its time as a floating exchange rate.

Huw McKay, Westpac: Until institutional structures come up to speed in emerging markets, will the exchange rate regimes remain vulnerable?

Mr Grenville: Indonesia survived 30 years of an exchange rate regime. So the established fact is that you can have regimes which are workable and they did have such a regime. The issue is when they come under pressure how do they react. And so part of the question is what pressure they're going to come under, and I'd have to say my hope would be that countries don't come under the sort of pressure which Asian economies have come under, came under in 1997 very often. Now, in the meantime, I think there are regimes which are feasible and which will hold together and which will do the job well and get a good price discovery process. So in other words quite workable regimes, which will survive until there is a very serious crisis. In the case of a very serious crisis maybe all bets are off.

Jay Horton, Price Waterhouse Coopers: My question is about the role of the IMF in promoting some of these new regimes which you have alluded to. It seems there are adjustments in that organisation which need to be made.

Mr Grenville: That's one of those questions which I think is a statement as much as anything; I could leave it on the table. We've made our views on the Funds policies in relation to Indonesia clear. We thought they could have done better in Indonesia, but my guess is they, like the rest of us, have learnt a lot in the process. And when I look at some of the issues that we criticised them over in the early days of the crisis, I think they've shifted quite a long way in their thinking in the right direction. So it would be wrong to think of the Fund as still strongly advocating policies which are very different from the things I've been talking about.

Media Office
Information Department
31 October 2000