

# ACI BRIEFING

NEWS FROM THE FINANCIAL MARKETS ASSOCIATION  
<http://www.aciforex.com>

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## In Memorium: William “Bill” Hahn

**It is with great sadness that ACI – The Financial Markets Association announces that its former Managing Director, Bill Hahn, passed away unexpectedly on June 16, 2007.**

Bill Hahn was appointed Business Development Director of our association in late 1996 by ACI’s Business Development Steering Committee. Before joining ACI, Bill worked in different positions in the financial markets for more than 40 years.

A UK citizen, he worked in the United States of America for Citibank’s international capital markets division (1980-87). Before that he was with First Boston Corporation for 15 years. He terminated his employment with a four-year secondment to the Kuwait International Investment Company. From 1987-95 he worked for Nikko Europe as Managing Director. In his last position before joining ACI he was manager of the London-based Lee Valley Partnership.



**“Bill was the driving force in our efforts to set up a worldwide electronic training and testing platform, he was the architect of our general communication platform, ACI Briefing, the originator of our web page and many other things”**

Manfred Wiebogen

In a letter to ACI members in which he expressed his shock at the news, ACI President Manfred Wiebogen says, “I enjoyed the privilege of knowing Bill from his very start within the ACI-organisation. We met first at the 39<sup>th</sup> International Congress in Toronto in 1997. In those days I was Secretary of ACI Austria and I still remember well having a long discussion with Bill regarding the future of our association. It was there and then when a long and intense cooperation and friendship started. Our mutual topics covered subjects like education, business strategy, financials etc. We worked together extremely close when I accepted responsibility as interim Treasurer of ACI in 2004.

“Whatever I did, wherever I needed help, Bill always proved to be “right and timely support”. Bill was also the driving force in our efforts to set up a worldwide electronic training and testing platform, he was the architect of our general communication platform, ACI Briefing, he was the originator of our Web page and many other things. He cared about our office and staff in Paris, he was more than close to our Kent Education Office, he was a true friend to so many – he cared about much.

“Bill was always straight-forward, he was a personality that sought compromise rather than conflict. He was open to new ideas, and worked extremely hard to “preserve in order to achieve,” in order to benefit from yesterday’s merits.

“Bill left us far too early, there was still so much for him to do – may his soul rest in peace, may he always have a place in our hearts.”

Tributes have also been paid to Bill from his long-standing colleagues within the organisation. Eddie Tan says, “ACI has been very fortunate to have a dedicated, responsible, tireless and determined Managing Director in Bill Hahn. Bill was never afraid of hard work and would not shy away from rolling up his sleeves to get the job done. I admired his work attitude and the willingness to walk the extra mile for ACI and her members. He was conscientious of the dynamics and complexities of ACI. He took much care and had the fortitude in managing the Board and Council members.

“Bill was indeed a true professional with a relentless spirit in pursuing excellence in what he did. I have fond memories of him and will certainly miss him.”

Honorary Past President of ACI, David Clark also has fond memories of Bill. “I met Bill when we interviewed him for the job which became Managing Director of ACI and remember vividly that he was the best of an outstanding group of candidates (over 100 people had applied for the job!). He had experience of both the trading side of the business as well as trade

associations, and was well known in the bond markets. He had an instinctive understanding of what our members would be like and how to manage them.

“At that time, ACI was putting most of its effort and resources into the education initiative, and Bill’s impact was essential for what was then the future success of the strategy. Wherever I went with him, he proved to be a mixture of a salesman and ambassador for the exams and ACI as a whole. He was a tireless traveller and a great supporter of the emerging market associations. He took calls more or less 24 hours a day and always got back to people.

**“He was a true professional and ACI would not be where it is today without him. Along with many others, I will miss him, and feel richer for having known him”**

David Clark

“He was a true professional and ACI would not be where it is today without him. Along with many others, I will miss him, and feel richer for having known him”.

An emotional tribute was paid by Werner Pauw, who has much to thank Bill for. “When I became active in ACI management, Bill was to a large degree my guidance, as I had to understand how the system worked,” he writes. “He taught me the lessons how to behave within international diversity, something that still stands me in good stead today. He will be greatly missed by Lorraine and myself, who had wonderful private conversations at exotic venues all over the world. Our deepest sympathy to his family and Cathy in particular – good bye my good friend, may you rest in peace.”

ACI’s Vice President Shadi Hanna calls Bill, “a friend that I will never forget” in writing. “With Bill Hahn's passing, ACI has lost a real pioneer and role model, and I have lost a true friend and mentor. So true a man was he, that even during his long hours of illness and suffering he did not miss one day when he would not call me during last July’s war in my country, asking about all his friends and the places that he knew in Lebanon when he spent time with his family during their vacation in 2001.

“Bill's course with pain was one that not many could have endured, yet his optimism and shining outlook never faltered. His last word to me was peaceful, serene and incredibly courageous: Inshallah (god willing). As his spirit rests, we will miss his presence, but the legacy that Bill Hahn has left us with is long before forgotten. For those who knew him, and those who knew of him, Bill is very much still living.”

Hanna’ colleague in ACI Lebanon, Saad, Jamaledine, currently Chair of ACI’s Board of Education, adds that he feels he has lost Bill twice, once professionally and now personally. “I lost him as a personal friend and a great supporter to Lebanon. The memories we had together in Beirut when he decided to spend a week’s vacation in Lebanon with his family is still present in my mind,” he says. “His daily phone calls during the July 2006 war in Lebanon were of great moral support to me and to my family, it proved to me

that he really cared. He demonstrated the genuine spirit of ACI brotherhood. I pray to his soul, he is now in heaven, I imagine him up there watching for us and for ACI wishing he was still between us to push our drives and plans forward.”

The last word goes to ACI’s Past President, Heering Ligthart, who worked closely with Bill during his six-year presidency of the Association. “Although we were aware of Bill’s condition, his death was still quite a shock. Last September I had the privilege and pleasure to attend his birthday party and at that time it was clear to me that he was really seriously ill,” he says. “We had a nice discussion together: looking back at the time we worked together in ACI. We looked forward also, as within a few months he would become a grandfather. He was still optimistic for the future and talked a lot about his family.

“Bill loved his family and his work, he contributed a lot to the implementation of ACI’s business plan as adopted at the World Congress of 1996 in Frankfurt. He was also very much in the driver’s seat in developing the electronic delivery of the exams. ACI owes quite a lot to Bill and we are grateful for what he has done. Unfortunately Bill enjoyed his retirement with his wife Cathy and the family only for a short period of time. Bill couldn’t win the fight with his health and his last trip was one way. Thanks my friend. Rest in Peace.”

Bill was laid to rest at a service in London on June 28.

## **Singapore Revives AP Forum**

**ACI Singapore has unveiled plans to revive the very successful Asia Pacific Forum with an event on August 30-31 2007.** The forum is a regional meeting involving participants from 15 financial centres in the Asia Pacific region, which seeks to provide a platform for 100 or more senior central bankers and elite global financial market professionals.

Asia Pacific Forum 2007 is ACI Singapore’s attempt at “enhancing and expanding the camaraderie and mutual help flourishing bilaterally among the national associations and groupings of financial market practitioners in this region”.

Based on the emerging markets growth theme of “New World, New Asia”, highlights of the Forum include two panel discussions on the afternoon of August 31, one led by the central bankers, the other led by the market practitioners.

ACI Singapore says that it expects to attract mid-senior decision makers in the global financial markets from investment banks of all sizes and reach, as well

as senior central bankers, operations managers and wealth managers.

The event will be held in Fullerton Hotel Singapore.

In a gesture to its fellow Associations, ACI Singapore says it will waive the delegate fee in a bid to spearhead and to encourage fellow National Associations to carry on this initiative in ensuing years (however, a no-show fee does apply).

### Programme

*Thursday, 30 Aug 07*

-- Morning & Afternoon: Networking golf

-- 7.00pm-8.30pm: Welcome Cocktail Reception

*Friday, 31 Aug 07*

8.30am-11.30am: ACI Asia Regional Meeting

12.15pm-2.00pm: Opening Lunch of Asia Pacific Forum

2.15pm-5.30pm: “New World, New Asia”, the market forum for local and overseas delegates including regulators here and in the region.

2.15 pm: Panel discussion one

Central bankers’ panel: “Regulatory issues in a rapidly growing Asia”.

2.45 pm: Tea break

3.00 pm: Panel discussion two

Market practitioners’ panel: “Emerging opportunities in a rapidly growing Asia”.

6.45-7.30pm: Registration and Pre-dinner Drinks

7.30pm-9.30pm: Gala dinner

Further details and registration information can be found on the ACI Singapore website, [www.acisin.com](http://www.acisin.com).

## **ACI Poland Hosts Repo Seminar**

**ACI Polska, with sponsorship from Reuters and ICAP hosted a one day repo seminar followed by a half day conference on June 14 and 15 in Warsaw**

At the opening on day one Tomasz Mironczuk, Secretary of ACI Polska opened the meeting by welcoming all the delegates, with Godfried De Vidts introducing the repo course in his capacity as Chairman of the European Repo

Council. The seminar with Richard Comotto as course director discussed the basics of the repo product, similar to the regular ICMA/ACI seminars held elsewhere in Europe. Eduard Cia from Unicredit Munchen covered the margin call procedures, Cedric Gillerot from Euroclear explained triparty, and Danny Corrigan from Icap provided his outlook as to how to set up a repo desk within a bank.

The conference on Friday morning was put together with a special purpose. Because the financial markets in Poland need to do some groundwork to make sure repo transactions will adhere to the European standards, specific topics were covered during an opening presentation by De Vidts to highlight to all, including officials from the central bank, the Ministry of Finance and the local CSD (central security depositry), the reasons why repo is so fundamental in the modern financial markets. In particular with the eventual move from the Polish zloty to the euro currency, all market practices as well as the regular tenders of the European Central Bank will need to be fully understood.

Habib Motani from Clifford Chance provided an overview of the benefit of the GMRA (global master rate agreement) followed by Andrzej Stosio from Norton Rose, who covered the particularities of the Polish legal system. Although currently some repo transactions happen with a domestic legal base, they are largely buy/sell banks and lack the necessary legal tools like netting. The fiscal difficulties of double taxation were then explained by Andrezej Paczuski, from KPT Doradcy Podatkowi, who was followed by a look at the current accounting system by Arkadiusz Krasowski from Ernst & Young, who stressed the need to switch to IFRS.

To conclude the conference, De Vidts provided an overview of the clearing and settlement issues currently so high on the agenda in Europe, followed by a presentation by Cia that covered the “what you need to know about Basle II”. These presentations were followed by a panel discussion which officially closed what was a very interesting two day event, before delegates attended annual meeting of ACI Polska.

Although the conference was over, there was a little extra for the foreign speakers, as De Vidts relates. “Because of thunderstorms over the European continent most of the speakers had between one and two hour delays,” he explains. “However, it was our Bavarian friend Eduard who pulled the short straw as his flight on Friday evening was, after a three hour delay, cancelled. So he ended up in a hotel in Warsaw. When he finally arrived in Munchen at 4PM on Saturday afternoon, his car showed no sign of life, but worse was to come. A terrible hail storm hit his residence and garden with terrible damage to both. We all hope that despite this unhappy ending, the Polish repo market will soon pick up and the members of ACI will be part of the secured financing community.”



**ACI**  
**Financial Markets Forum**  
Fit for Future Leadership

Looking at the issues facing leaders  
in our industry today

**1 – 4 November 2007**  
**Davos/Switzerland**

Target audience:  
Senior financial market professionals  
with at least 5 years experience in the market

Conference language: English



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## ACI Thanks Canada – Looks Forward to Austria

A spectacular acrobatic show and the traditional handing over of the flag of ACI – The Financial Markets Association brought the curtain down on three great days in Montreal at the 46<sup>th</sup> ACI World Congress.

Delegates in the business sessions were treated to an insightful two days as a stream of distinguished panellists discussed all things financial markets including; the influence of investment flows upon the currency markets; economic prospects from a central bank viewpoint; Alpha and the currency markets as well as two panels on the future of the foreign exchange markets and the evolution of electronic trading.

Two keynote addresses stood out during the event, one from Bank of Canada Governor David Dodge, the other from Timothy Geithner, President of the Federal Reserve Bank of New York. Their speeches are presented below.

An extremely busy exhibition hall ensured that the pace of the Congress never let up and as always at ACI World Congresses, ACI events in general in reality, there were plenty of opportunities for networking and re-establishing old friendships.

The committee of the Financial Markets Association of Canada were complimented on a superbly organised event and congratulated on its undoubted success.

Attention now switches to Vienna and the scene of the 47<sup>th</sup> World Congress, hosted by ACI Austria from May 29-31 2008. Details of how to register can be found on [www.aci-austria.com](http://www.aci-austria.com).

## Dodge Debates Currency Regimes at World Congress

*The following is a transcript of the speech delivered by David Dodge, Governor of the Bank of Canada, at the 46<sup>th</sup> World Congress of ACI – The Financial Markets Association in Montreal.*

Thank you and good morning. It's great to be here and to have an opportunity to talk about some key issues that relate to your meeting's theme of convergence. I think that it is very important that economies all over the globe converge towards becoming part of a market-based, liberalised trade and financial order.

**“Large currency movements, such as the roughly 35% appreciation in the Canadian dollar since 2003, can be hard for businesses to deal with”**

Why do I think that such an order is so important? Well, in part it's because history has helped to demonstrate its virtues. But it's also extremely important to bear in mind the context, that is, the world in which we live today. This is a world in which adjustment is perpetual, where change is driven by the development of new technologies, where sectors and nations continually attempt to secure some new advantage. And in this world, price signals from markets help us to understand what adjustments are needed.



So, this market-based, liberalised trade and financial order is really the best that we have found for promoting growth and prosperity. But it is critical that members of this system adhere to a common set of rules or policies that operate for the benefit of all. In this way, we can encourage a healthy pace of global economic growth.

Of course, many policies are necessary to move an economy towards converging on a market-based, liberalised trade and financial order. I'll elaborate further in my remarks on some of those policies. But today, I will focus on one particular policy. That is the vital role that a flexible exchange rate regime can play for many countries in helping their economies to operate for the maximum benefit of all citizens.

### **Why a Flexible Exchange Rate is the Right Choice for Many**

Now, I should be clear right off the top that I'm not saying a floating exchange rate is the one and only choice for all countries at all times. A fixed exchange rate can be the right choice for economies – especially small economies – where an independent monetary policy is difficult to execute. In such a situation, the costs associated with having a flexible currency may outweigh the benefits. But for many – and indeed, for most large economies – a flexible exchange rate can bring important economic benefits, benefits that clearly outweigh the costs.

A flexible rate supports a market-based, liberalized financial order, an order that has the great advantage of providing for continuous adjustment in response to price signals. A flexible exchange rate adds one more market-determined price. It not only absorbs shocks, but it uses prices to facilitate changes.

At the same time, we must always remember that a flexible exchange rate is just one of several key policies that are critical to achieving economic

efficiency. But a flexible rate is crucial if a country is to pursue an independent monetary policy aimed at price stability.

During my remarks, I will illustrate some of my points by drawing on Canada's lengthy experience with a floating exchange rate. Our experience can be very instructive for others, even though 57 years have passed since Canada broke with the Bretton Woods system and implemented a flexible exchange rate regime. We have had more experience with this type of exchange rate mechanism than almost any other country in the world, so we have a deep understanding of how it works.

Canada's bold – some might say radical – decision in 1950 to break with the Bretton Woods system was driven by a couple of problems. Some of these problems still plague many emerging-market economies today. In the late 1940s, Canada was dealing with a large inflow of foreign capital and postwar investment, as well as strong household demand. Following an earlier revaluation of the Canadian dollar, short-term capital was flowing heavily into the country amid speculation about another revaluation. Rising commodity prices were also adding to upward pressure on the dollar. All of this led to concerns about inflation, as well as worries that capital inflows might lead to a sizable increase in the country's foreign debt. Unfortunately, the fixed exchange rate meant that policy-makers had to focus monetary policy on exchange rate stability, rather than on steps that would have been appropriate to stabilise domestic prices.

**“The Bank of Canada today still has no specific target for the dollar, because we believe that market conditions should determine the currency’s value”**

To give the Bank of Canada the freedom to pursue policies aimed at stabilising prices, authorities took the critical step of allowing the dollar to float at values set by the market. I'd also like to remind everyone that this policy continues: the Bank of Canada today still has no specific target for the dollar, because we believe that market conditions should determine the currency's value.

The 1950 decision to float the currency was controversial, especially with the International Monetary Fund and most of its member states, which subscribed to a fixed exchange rate regime. But in the postwar years, experience proved that a floating exchange rate was truly beneficial for domestic policy.

However, during the 1970s and 1980s, the Canadian-dollar foreign exchange market was quite thin. As a result, the Bank of Canada had to intervene on a day-to-day basis with the aim of providing liquidity and reducing volatility. This strategy of "leaning against the wind" was pursued symmetrically, with the goal of smoothing fluctuations in either direction. By the 1990s, however, markets had become deep enough that daily interventions were no longer helpful. Government policy now restricts such interventions to the most exceptional circumstances and, in fact, Canada hasn't intervened to influence the Canadian dollar since 1998.

## **Uncertainty Under Fixed and Flexible Exchange Rates**

Despite Canada's success with a flexible exchange rate system, there are still critics who find it hard to deal with the uncertainty that can come with a floating dollar.

Large currency movements, such as the roughly 35 per cent appreciation in the Canadian dollar since early 2003, can be hard for businesses to deal with. A floating currency does entail somewhat larger transactions costs and, in the short run, additional risks for business. In this regard, the development of deep and well-functioning forward foreign exchange markets is extraordinarily important in assisting businesses to hedge their foreign exchange risk. Such well-developed markets, along with financial institutions geared to providing business – especially small business – with the opportunity to hedge at low transactions cost, minimise the additional exchange risks that businesses face under a floating exchange rate regime.

But even with well-developed foreign exchange markets and the ability of firms to hedge, some still fear that a flexible exchange rate will introduce undue risks and uncertainties. They argue that fixed exchange rates are the solution. But a fixed exchange rate is no panacea. Over time, a fixed nominal exchange rate can actually heighten uncertainty and, eventually, add to volatility. A fixed rate limits the actions of central bankers because monetary policy must be aimed at protecting the fixed level of the exchange rate.

Under a regime of fixed nominal exchange rates, the economy is forced to absorb the full effect of changes in world prices through changes in domestic nominal wages and prices. To bring this about, the burden initially falls on output and employment and, eventually, spreads to most wages and prices. And because domestic wages in particular tend to be "sticky," changes in output and employment need to be quite large. Thus, adjustment tends to be more difficult and more costly for many individuals, businesses, and the economy, than would be the case under a flexible exchange rate regime.

In economies where domestic wages and prices are not perfectly flexible, it's not only central bankers who face constraints under a fixed exchange rate regime. Controls on financial transactions will often be required, and eventually, controls over parts of the real side of the economy may be needed to maintain the fixed nominal exchange rate. Authorities who ignore these constraints, or who lack the fiscal discipline required by a fixed exchange rate regime, can end up creating uncertainty and the very volatility that they were trying to avoid.

## **Economic Benefits of a Flexible Exchange Rate**

**“The greatest benefit Canada has found with a floating currency is the way in which it helps the economy deal with economic shocks”**

Let me just say that the greatest benefit Canada has found with a floating currency is the way in which it helps the economy deal with economic shocks. Perhaps this is a good time for me to take a moment and explain in more detail just how the floating exchange rate system now fits into Canada's monetary policy framework. Our monetary policy aims to protect the domestic purchasing power of our currency by keeping inflation low, stable, and predictable. We aim to keep inflation, as measured by the consumer price index, at a 2 per cent target. By doing so, we support the conditions necessary for strong, sustainable economic growth.

Of course, there will always be economic shocks that require a response and adjustment. As a medium-sized, open economy and an important producer of commodities, our terms of trade can shift significantly as the relative prices of commodities, manufactured goods, and services change. Such changes in relative prices are a signal to shift real resources out of sectors with declining profitability, and into sectors where profits are rising. Under a floating rate regime, movements in the currency help to smooth that process and to minimise the adjustments in other areas of the economy.

This all serves to demonstrate why it has been very important to us to maintain our flexible exchange rate, rather than fix our currency to the US dollar. The United States is certainly our closest neighbour and by far, our largest trading partner. But the structures of our two economies are very different. This means that each of us often requires different adjustments and different policies in reaction to shocks. Canada's floating exchange rate facilitates these adjustments without forcing our economy through some very difficult changes in the overall level of output, wages, and prices.

Let me put this in more concrete terms and, in so doing, share a valuable lesson learned from the Asian crisis of 1997. As a commodity-producing nation, we were hit pretty hard by the dramatic fall in commodity prices. Our floating dollar fell sharply and thus, helped with the significant but necessary adjustment. With the decline in the nominal exchange rate, our non-commodity sectors saw their competitive positions improve. They were therefore able to absorb some of the resources that were being quickly shed by the commodity producers. Our floating exchange rate allowed us to achieve a decline in *real* wages without a decline in *nominal* wages and to hold inflation near our target.

Let me give you another example. In recent years, the demand for and the prices of Canadian commodity exports have been rising sharply. This has helped to create an economic boom, and investment flows into Canada have increased. Our floating dollar has appreciated sharply and thus, has forced some necessary adjustments. As their competitive positions improved, our commodity producers have been able to absorb some of the resources that

were being shed by the non-commodity sectors, which have seen their competitive positions deteriorate.

As a result, we've seen a shift in relative wages without fuelling inflation. Thus, the flexible exchange rate has again helped the economy to absorb shocks and has allowed the Bank of Canada to keep inflation near the two per cent target. Adjustment is never easy, but on balance, a flexible exchange rate regime has definitely helped Canada to maintain production close to full capacity and to minimise the effects of the boom-bust cycles in various sectors.

A floating exchange rate can bring a number of important benefits, but as I said, there are other important components of a sound policy framework. A well-functioning domestic financial system is crucial to achieving efficient domestic allocation of capital and to dealing with external shocks. That is why policy-makers around the world have been putting a lot of emphasis on improving domestic banking and financial systems. Organizations such as the G-7, the G-10, and the Financial Stability Forum have all examined ways to improve financial system stability. And for his hard work in this area, I'd like to congratulate Tim Geithner of the U.S. Federal Reserve, who is also your next speaker. With all of these efforts, we have seen some real improvements in financial system stability in recent years.

Since the 1990s, countries have also found that it's very important to develop domestic markets for debt, for their own protection, as well as for the good of the global economic system. And in this area, we have also seen some real signs of progress. A decade ago, with the peso crisis still fresh in people's minds, who would have believed that Mexico would be in a position today to issue long-term, fixed-rate, peso-denominated bonds at such narrow spreads over U.S. Treasuries?

Fiscal policy is also important. Governments must behave in a fiscally responsible manner. That doesn't mean that the books must be perfectly balanced each and every year. But it does mean that governments must maintain, and be committed to maintaining, a manageable debt-to-GDP ratio and avoid running up debt that will tie the hands of future governments.

## **Conclusion**

Let me conclude by going back to where I started my remarks. I have spoken about how a liberalised, global trade and financial order is important for promoting economic growth and prosperity. And I have focused on the importance of a floating exchange rate regime, which is a key element in promoting good performance, both domestically and globally. For systemically important countries, we should be promoting floating rates supported by well-developed and well-functioning domestic financial markets.

**“Governments must behave in a fiscally responsible manner. That does not mean that the books have to balance each and every year, but it does mean that governments must maintain, and be committed to maintaining, a manageable debt-to-GDP ratio and avoid running up debt that will tie the hands of future governments”**

But it has to be acknowledged that it can take some time for emerging-market economies to put these well-developed markets in place. And along the way, some management of capital flows and a degree of intervention in foreign exchange markets may be needed, in these economies. These capital controls and foreign exchange interventions are awkward, and over time, they can lead to a lot of problems. So they must be eliminated as quickly as possible. But, to the extent that countries are making progress towards more flexible exchange rate regimes, those of us with well-developed markets already in place will have to have some tolerance for this awkwardness. And those of you in the ACI will have to continue to trade in this somewhat awkward environment.

In the meantime, I can say that we at the Bank of Canada will be doing all that we can to provide assistance and to persuade countries in transition to move as rapidly as possible, to facilitate the desired convergence.

## New York Fed President Reflects on the Global Economy

*Remarks of Timothy Geithner, President of the Federal Reserve Bank of New York at the ACI World Congress in Montreal.*

Good morning. I am pleased to be able to join you today. And it is a privilege to be here today with Canada's accomplished central bank governor, David Dodge. There are few people in central banks or in governments around the world today that have presided over as far reaching and successful a set of macroeconomic policy reforms as has David Dodge.

I want to offer some reflections about the challenges managing macroeconomic policy in a more open and integrated world economy. And I want to say something about how the international monetary system, and the current framework of exchange rate regimes, might develop in the coming years.



**“Among emerging economies we have seen a marked trend towards more floating exchange rate regimes. This is particularly pronounced in parts of Latin America”**

For the past century or more, choices about exchange rate regimes have played an important role in economic outcomes across countries. From the Gold Standard of the late 19th and early 20th centuries through the Bretton Woods system and the episodes of exchange rate cooperation among the G5 and the G7 in the 1980s and after, the desire to achieve exchange rate stability was a major preoccupation of policymakers. The economic damage inflicted by the disastrous competitive devaluations among the major economies in the

1930s had a profound influence on thinking during much of the postwar period. And for governments and enterprises around the world today, the aversion to large fluctuations in exchange rates remains strong.

As the world has become more open to trade and more closely integrated, this sensitivity to exchange rate variability has intensified. And yet, experience suggests that resisting variability makes the adjustment to changing economic conditions more painful. In an increasingly open world economy, the ability to cope with change becomes more important, and for a large fraction of the world economic, exchange rate flexibility is a necessary condition for sustained favourable economic performance.

Changes in fundamental factors such as productivity growth and the inevitable shocks to demand and supply require changes in relative prices, both domestically and internationally. A flexible exchange rate regime makes it easier for relative prices to move rapidly and effectively in the appropriate direction, and this generally eases the cost of that adjustment.

Even in a fixed rate regime, this adjustment in response to changing circumstances will ultimately have to take place, of course. But if relative prices cannot adjust through the exchange rate, domestic output and employment will have to bear the brunt of adjustment instead.

Since the collapse of the Bretton Woods system, we have seen the emergence of a diverse range of exchange rate arrangements. The large industrial economies have, by and large, decided to let their currencies adjust to changing circumstances without official intervention in exchange markets. Japan aside, it is now close to seven years since the last episode of concerted intervention among the major economies; and there has been no Japanese intervention for two years.

Among emerging economies, too, we have seen a marked trend toward more flexible exchange rate regimes. This is particularly pronounced in parts of Latin America. At the other end of the spectrum, some of the newer members of the European Union are gearing up to adopt the euro. Somewhere in the middle between these extremes of flexible exchange rate regimes and full monetary integration are the emerging market economies, mostly in Asia and among the major oil exporters in the Gulf, that still sustain fixed or partially fixed exchange rate regimes. Most of these countries link their currencies to the dollar, though we see varying degrees of flexibility in the closeness of that link.

How has the world fared under this diverse mixed of flexible and fixed exchange rate regimes?

In general, I think, the costs of living with exchange rate volatility have been less than feared and attempts to limit volatility have been more damaging and less effective than expected.

Take the experience of the major economies. Despite periods of very substantial swings in exchange rates, and the amplitude of the changes in exchange rates among the major currencies since 1973 have been exceptionally large, economic growth in the major economies have become more stable, not less. Quarterly GDP volatility in the United States, for example, has fallen by more than half since the mid 1980s. And average rates of inflation and the variability of inflation outcomes have of course declined substantially as well. This is not to say that these swings in exchange rates have not come with pain and trauma, only that overall economic performance has fared better than many would have expected three decades ago when contemplating life under flexible exchange rates.

**“In general, I think, the costs of living with exchange rate volatility have been less than feared and attempts to limit volatility have been more damaging and less effective than expected”**

Among emerging markets, experience with exchange rate flexibility has been more limited, and the record has been more mixed. Chile probably has one of the longest records of successful performance under a flexible regime, success due in large part of course to a strong record of prudent macroeconomic policy management and strong institutions. But there are many more examples today—Brazil and Mexico are two—of emerging economies with sustained periods of improved growth and inflation outcomes under more flexible exchange rate regimes.

Emerging market economies face substantially greater challenges than the less open major economies in adjusting to a more integrated world and to the greater exposure to real and financial volatility that comes with integration. Large movements in capital flows can complicate the task of achieving sustainable growth, low inflation and financial stability. This is obvious for those countries experiencing sharp net outflows of capital, but the challenges are formidable even for those countries experiencing sustained periods of large inflows. And even those countries with more flexible exchange rates can see competitiveness eroded if their major trading partners resist exchange rate appreciation. For most countries, though, these challenges would be exacerbated rather than eased by a policy designed to try to sustain a fixed rate or to narrowly constrain variability in the exchange rate. Although it may seem counterintuitive, small open economies, even more than larger less open economies, need the flexibility that floating exchange rates bring.

Changes in exchange rate regimes were present at the scene of most of the major emerging market financial crises of the last decade, and many have argued that the decisions to let the exchange rate adjust was a major source of the trauma that followed. But that's not a fair reading of the evidence. In general, the crises were the consequence of fundamental economic problems, often manifested in the build up of substantial balance sheet problems, with

excessive borrowing in foreign currency by the sovereign, the banking system, or both.

These balance sheet problems were one reason many governments chose to postpone currency adjustment for as long as possible, and these delays ensured that the cost of adjustment, when it was forced on these governments, was far higher than if action had been taken earlier. But this is not the whole story since the fixed exchange rate regime itself had contributed to the initial currency mismatch and associated balance sheet problems. By engineering artificial expectations of stability, the regime had led market participants to disregard the possibility of exchange rate devaluations, leading to mis-pricing of risk, insufficient hedging and ultimately to misallocation of financial and real resources.

Governments that found themselves in this position had very limited ability to mitigate the economic damage that was to come, but the policy choices that accompanied the exchange rate change often compounded the problem.

Japan's experience provides another example, though the context was different. There is a perception in parts of Asia that the Japanese government's decision to let the yen appreciate in the late 1980s was principally responsible for Japan's so-called "lost decade" of low growth. And, Japan, viewed through this prism, is cited as an example of the perils of letting an exchange rate move up in response to changing fundamentals. The reality is more complex. The problems of the Japanese economy in the 1990s were largely due to the after effects of the collapse of the real estate and asset price boom of the preceding decade, a boom fuelled in part by efforts by the monetary authorities to limit the appreciation of the yen.

The size of the negative shock to demand from the collapse of the bubble was very substantial, and the capacity of the government and the central bank to mitigate the damage was constrained by the weakness in the banking system. A more forceful macroeconomic policy response, however, might have brought about a quicker recovery. In any case, the problem with the exchange rate choice was not the decision to let the rate adjust, but the decision to resist it and the role that played in magnifying the bubble, and thereby the subsequent damage from the fall.

Given where we are today, and what we know about the relative merits of flexible and fixed exchange rate regimes, what is the likely evolution of the current monetary system going forward?

A few concluding observations.

First, I think it is unlikely that we will see a substantial move toward monetary integration involving the major emerging market economies, in Asia or in the Western Hemisphere. As the economist Peter Kenen writes in his latest book,

**"The problems of the Japanese economy in the 1990s were largely due to the after effects of the collapse of the real estate and asset price boom of the preceding decade, a boom fuelled in part by efforts by the monetary authorities to limit the appreciation of the yen"**

it is difficult today to envisage a substantial reduction in national currencies though the emergence of large regional monetary unions where they do not already exist.

Within Europe, we may yet see a further enlargement of the euro area. There may be other circumstances in which individual economies can derive benefit from a currency board system or from dollarisation or euroization. Countries trying to emerge from a period of high inflation may in the future, as they have in the past, adopt a fixed exchange rate as a nominal external anchor for a disinflation strategy. These seem likely to be exceptions, however, to a general move toward more flexible exchange rate regimes.

Even as regional economic integration increases in Asia and other parts of the world, these economies seem a long way from the point where economic, or political conditions, will make a compelling case for monetary integration. In Europe, of course, the political case for monetary integration to a large extent preceded the economic case. And the architects of the European Union integration worked consciously to induce a level of economic integration in Europe that would induce conditions that more closely met the economist's test for an optimal currency area.

For most of the emerging markets today, in contrast, the challenge is to establish the conditions that will enable them to live more comfortably in a world where their exchange rates will adjust more freely in response to changing fundamentals. As these economies become more open to capital flows, they will necessarily find it more difficult to occupy the tenuous middle ground with an exchange rate regime that is neither fully fixed nor flexible, but managed in a way that closely tracks the value of the dollar or carefully constrains fluctuations against the dollar.

This does not mean that these countries can be indifferent to exchange rate movements or that the exchange rate is irrelevant to the conduct of monetary policy. For many small open emerging economies, price stability and exchange rate stability are obviously intertwined, and a monetary rule that responds effectively to inflation pressure cannot afford to overlook the signals coming from the foreign exchange market. But attempts to target a particular level for the exchange rate or the slope of the change in the rate in response to different conditions will, as the capital account becomes more open, inevitably, come with substantial risks to monetary and financial stability.

Managing the transition to a more open capital account and a more flexible exchange rate regime is not a simple task. These transitions need to be handled with care and attention to the development of a strong institutional framework for monetary policy and the financial system. The more successful transitions came in contexts where the monetary authorities were independent of political constraint, where balance sheet problems and currency mismatches

in the government and the financial system were not acute, where the prevailing legal framework provided reasonable protections for property rights and the enforcement of contract, and where there was effective supervision of the banking system. Where these conditions were weaker, the transitions from fixed exchange rate regimes were more traumatic.

These conditions seem exacting, and the understandable need for caution often is invoked in defence of protracted and very gradual transitions. A certain degree of caution is wise: there is a great deal of risk in a poorly managed and premature shift toward flexibility. But there is risk in gradualism too. Delay magnifies the costs of living with the distortions caused by a managed rate.

Once relaxed, exchange and capital controls are both difficult and costly to reintroduce, and even relatively modest steps back from an open regime can be damaging to confidence and credibility, without buying much in the way of lasting stability.

The policy responses to the challenges that come with economic and financial integration principally involve choices for governments at the national level. International cooperation can in some circumstances help provide a more supportive environment, but there are no feasible changes to the architecture of the international financial system that offer the prospect of a durably stable external economic and financial environment for nations, large or small. Fundamentally, the only realistic choice for policymakers is to equip their economies with the flexibility to cope more successfully in this increasingly integrated global economy. And this means preparing for a world of more rather than less flexibility in exchange rate regimes.

## Repo Course Debuts in Moscow

The first Professional repo market course, organised by ICMA and NSMA in Moscow, in association with ACI – The Financial Markets Association and ACI Russia, attracted some 140 delegates from Russia and neighbouring countries. Based on the experiences of previous conference in Europe and Asia, the main focus behind the event was to bring the dealer community, as well as officials within Russia, a pallet full of topics that can contribute to the development of this particular market in Russia.

After a welcome ceremony that included Konstantin Volkov, President of NSMA, Godfried De Vidts as Chairman of the European Repo Council and



Alexey Akinshin, Chairman of the Russian Repo Council, the legal agreement necessary to trade in this market was discussed in detail. Both from an international perspective through the GMRA and from a local perspective as the Russian State Duma has still to adopt a few legislative measures for this to work.

As the delegates dug into the operational and legal structure of repo, with a lecture given by the course director Richard Comotto, a press conference was held by both Volkov and De Vidts, also attended by Eduard Cia, a member of the European Repo Committee and the main financial sponsor of the event.

In line with many ACI traditions, there was of course a social event on the first evening that took the delegates by bus through the busy streets of Moscow for a sightseeing tour. Walking from one side of the red square to the other past the Kremlin walls brought us to the National Hotel for a dinner sponsored by Unicredit. Here new professional relationship and contacts were established, while the gathering was watching the world go by in full view of the impressive Kremlin complex.

At the end of the second day of the conference, a ceremony was held where Volkov and De Vidts presented a certificate to each of the delegates for attending this professional course. The real works starts now, however, as the Russian markets have to establish DVP (delivery versus payment), a CSD (central security depository), and CCP (central counterparty) in order to have a fully-fledged infrastructure for the repo markets to grow into a success. The European Repo Council has agreed to work with the NSMA to fulfil this goal.

## ACI UK Delivers on a Promise



On the 15th May ACI UK held its annual Charity Golf Day at Leatherhead Golf Club with, as usual, all profits going to it's chosen charity – the Variety Club of Great Britain Sunshine Coach programme.

It was a little disappointing as there were only seven teams entered this year, with Forex Ireland Golf Society having to withdraw at the last moment. Those teams that did compete were HSBC, Barclays Capital, SEB, State Street, Northern Trust, Icap and the Variety Club of Great Britain and a good time was had by all, despite the weather, which was the worst of any of the Charity Golf Days that ACI UK has ever staged with intermittent rain and gusting winds.

The winners were the Variety Club of Great Britain captained appropriately enough by Keith Andrews, the Chairman of the

Variety Club Sunshine Coach division. Also in their team was Adger Brown, a comedian who has appeared on several TV shows and adverts, who gave us a 15 minute performance during the dinner and certainly gave us all a good laugh, which helped after the tough conditions they had had to face during the round!

The funds raised have not yet been finally counted as there are some payments to come as well as some invoices to be paid but, with the kind generosity of FIGS who have decided to send us their usual contribution despite not being able to make it for the day, it is estimated funds going to the purchase of a Sunshine Coach will be in the region of GBP15,000.

At the day itself a coach was presented to Ravensbourne School with the FIGS logo on the doors and the teachers and children had a great day with food and drink on hand and the official presentation of the keys to the school, to the delight of all the children.

Alan Attwood, who helped organise the event, says, "I hope that next year this worthy cause will get more support from the financial markets institutions and enable us to donate even more coaches to help those less fortunate than ourselves."

## **DSC Pace Continues**

Fresh from its busiest year ever in 2006, the ACI Australia Dealing Simulation Course is set for a very busy second half of 2007. With courses in Australia, Sri Lanka and the UK already under its belt, the course is now set for Kenya, Hungary, Australia and North America.

In the case of Kenya, from August 13-17, and the US, for which the date is to be finalised, the course will be making its debut. Australia holds its second course of the year from September 2-9 and Hungary is fixed for October 9-14 at Cegled.

Places are still available for most courses, anyone wishing to enquire further should contact either the local ACI National Association or [chris.howlett@aciaustralia.com.au](mailto:chris.howlett@aciaustralia.com.au).

## **Slovenia Holds 15<sup>th</sup> AGM**

ACI Forex Slovenia met for their 15<sup>th</sup> annual general assembly with an opening reception for the members and a large group of mostly neighbouring ACI members at the Ljubljana Castle overlooking the capital of this two million inhabitants green country.

The next morning the AGM itself took place in Predjama Castle. After the opening by ACI Slovenia President Branko Kobal, the usual Secretary and



Bloomberg.

Treasury reports were presented by Janja Pusnik and Bojan Plibersek, respectively. Pusnik briefed the meeting on the proceedings at the World Congress which was a nice introduction for the newly-elected President of ACI – The Financial Markets Association, Manfred Wiebogen. He outlined his ideas for his presidency, referring to the need to re-connect with the members while at the same time restructure the way the Association delivers its program to the world-wide membership.

His speech was followed by Godfried De Vidts, who delivered a speech entitled, “The Role of the Repo Markets in the Eurosystem”. Finalising the official part of the meeting, Robert Cutler presented the FX solutions and developments currently available from

In the afternoon, time was spent in the Postojna Cave, which boasts five kilometres of underground train tracks in a complex totalling some 21 kilometres of tunnels. In the evening, the gathering returned for the Gala Dinner at the Hotel Union in the capital Ljubljana.

# Web Listing

**ACI - The Financial Markets Association**

[www.aciforex.com](http://www.aciforex.com)

**Argentina:** Forex Club Argentina

[www.forexclubargentino.com.ar](http://www.forexclubargentino.com.ar)

**Australia:** ACI Australia

[www.aciaustralia.com.au](http://www.aciaustralia.com.au)

**Austria:** ACI Austria

[www.aci-austria.com](http://www.aci-austria.com)

**Belgium:** ACI Belgium –

The Financial Markets Association

[www.acibelgium.com](http://www.acibelgium.com)

**Canada:** Financial Markets Association of Canada

[www.fmac.ca](http://www.fmac.ca)

**Channel Islands:** ACI Channel Islands

[www.acici.com](http://www.acici.com)

**Croatia:** ACI Croatia

[www.forexcroatia.hr](http://www.forexcroatia.hr)

**Czech Republic:** ACI –

The Financial markets Association of the Czech Republic

[www.aciforex.cz](http://www.aciforex.cz)

**Denmark:** ACI Forex Denmark

[www.aciforexdanmark.dk](http://www.aciforexdanmark.dk)

**Egypt:** ACI Egypt – The Financial Markets Association

[www.aciegypt.com](http://www.aciegypt.com)

**Finland:** ACI Finland

[www.acifinland.fi](http://www.acifinland.fi)

**France:** AFTB/ACI France

[www.acifrance.net](http://www.acifrance.net)

**Germany:** ACI Deutschland e.V.

The Financial Markets Association

[www.aci-germany.de](http://www.aci-germany.de)

**Greece:** Forex Greece

[www.forexhellas.gr](http://www.forexhellas.gr)

**Hong Kong:** Treasury Markets Association of Hong Kong

[www.tma.org.hk](http://www.tma.org.hk)

**Hungary:** ACI Hungary

[www.acihungary.hu](http://www.acihungary.hu)

**Iceland:** ACI Iceland

[www.aciiceland.com](http://www.aciiceland.com)

**India:** Forex India

[www.forexindia.org](http://www.forexindia.org)

**Ireland:** ACI Ireland

[www.aciireland.com](http://www.aciireland.com)

**Italy:** ATIC Forex (Italy)

[www.aticforex.com](http://www.aticforex.com)

**Japan:** ACI Japan

[www.forexclub-japan.com](http://www.forexclub-japan.com)

**Jordan:** Jordan Forex Association

[www.jordan-forex.com](http://www.jordan-forex.com)

**Kuwait:** Kuwait Financial Markets Association

[www.kfma.org.kw](http://www.kfma.org.kw)

**Lebanon:** ACI Lebanon –

The Financial Markets Association

[www.acilebanon.com](http://www.acilebanon.com)

**Luxemburg:** ACI Luxembourg – The Financial Markets Association

[www.acilux.com](http://www.acilux.com)

**Macau:** The Macau Financial Markets Association

[www.mfma.org.mo](http://www.mfma.org.mo)

**Macedonia:** ACI Macedonia – The Financial Markets Association

[www.acimacedonia.org](http://www.acimacedonia.org)

**Malaysia:** Financial Markets Association- Malaysia

[www.ppkm.net](http://www.ppkm.net)

**Malta:** ACI Malta – The Financial Markets Association

[www.acimalta.com](http://www.acimalta.com)

**Monaco:** ACI Monaco

[www.acimonaco.com](http://www.acimonaco.com)

**Netherlands:**

ACI the Netherlands – The Financial Markets Association

[www.aciforex.nl](http://www.aciforex.nl)

**Norway:**

ACI Norge – The Financial Markets Association

[www.acinorge.com](http://www.acinorge.com)

**Pakistan:** Financial Markets Association of Pakistan

[www.fma.com.pk](http://www.fma.com.pk)

**Philippines:** ACI Philippines

[www.aciphils.com](http://www.aciphils.com)

**Poland:** ACI Poland

[www.acipolska.pl](http://www.acipolska.pl)

**Portugal:** Forex ACI Portugal

[www.forex-aciportugal.com.pt](http://www.forex-aciportugal.com.pt)

**Romania:** ACI Romania

[www.aciromania.ro](http://www.aciromania.ro)

**Russia:** ACI Russia – The Financial Markets Association

[www.acirusia.ru](http://www.acirusia.ru)

**Singapore:**

ACI Singapore - The Financial Markets Association

[www.acisin.com](http://www.acisin.com)

**Slovakia:** ACI Slovakia

[www.acislovakia.sk](http://www.acislovakia.sk)

**Slovenia:**

ACI Slovenia – The Financial Markets Association

[www.forex-club.si](http://www.forex-club.si)

**South Africa:** ACI South Africa

[www.aciforex.co.za](http://www.aciforex.co.za)

**Spain:** AMF/ACI Spain

[www.asociacionmercadosfinancieros.com](http://www.asociacionmercadosfinancieros.com)

**Sweden:** ACI Sweden

[www.acisweden.com](http://www.acisweden.com)

**Switzerland:**

ACI Suisse - The Financial Markets Association

[www.acisuisse.ch](http://www.acisuisse.ch)

**United Kingdom:**

ACI UK – The Financial Markets Association

[www.aci-uk.com](http://www.aci-uk.com)