



## External Relations

During the year, the participation of Bank Negara Malaysia (BNM) in international, regional and bilateral fora continued to focus on efforts to promote closer monetary and financial co-operation and to encourage the international community to accord due consideration to views and concerns on global issues affecting emerging economies.

These were discussed in regional meetings of the Association of South-East Asian Nations (ASEAN) Finance Ministers (AFMM), ASEAN Central Bank Forum (ACBF), South-East Asian Central Banks (SEACEN), Executives' Meeting of East Asia and Pacific Central Banks (EMEAP), Asia-Pacific Economic Co-operation (APEC), Asia-Europe Meeting (ASEM) and Group of 15 (G-15). International meetings included those of the Bank for International Settlements (BIS), International Monetary Fund (IMF), World Bank and World Trade Organisation (WTO). The focus of discussions at these meetings in 2000 was on the progress of reforms in the international financial architecture, initiatives for regional co-operation and issues on regional and global surveillance.

Discussions on regional surveillance during the course of 2000 and early 2001 focused

visitors from other central banks, including those coming for attachment programmes. Training programmes extended to other central banks also increased significantly.

### *Reform of the International Financial Architecture*

Reform of the international financial architecture (IFA) remained an important issue on the agenda of regional and international fora in 2000. BNM's participation sought to emphasise the importance for the international community to persevere with IFA reforms. At various fora, including the IMF, APEC, ASEM and G-15, BNM voiced concerns over the risks of complacency among the international community on IFA reforms, following the strengthening of economic recovery in the crisis-affected countries in Asia and the restoration of a more positive global economic environment. Concern was also expressed over the slow progress in terms of measures to promote greater transparency by the private sector.

The emphasis by the IMF, World Bank, the Financial Stability Forum (FSF) and other international fora continued to be biased

IFA reforms in 2000 continued to focus on measures by national authorities to enhance transparency and risk management. Malaysia expressed concern over the slow progress of similar efforts by the private sector, and reiterated the need for a global mechanism to monitor and manage capital flows.

substantively on exchange rate and banking and corporate restructuring issues. BNM's bilateral relations in 2000 continued to emphasise information exchange and co-operation among central banks. The Bank also actively promoted Bilateral Payments Arrangements (BPAs) with several countries in order to enhance South-South trade and to diversify the profile of Malaysia's trading partners. In 2000, BNM received a significant increase in the number of

towards efforts to encourage national authorities to implement agreed initiatives to enhance **transparency and risk management** to reduce vulnerabilities to financial crises. In this regard, a notable development in 2000 was the decision by the FSF to establish a working group to explore issues related to market and official incentives to encourage the public sector as well as the private sector to implement international standards. A further

### Financial Stability Forum (FSF) Task Force on Implementation of Standards

- The Task Force was established on 15 September 1999 with the following objectives:
  - To explore key issues; and
  - To consider a strategy for fostering the implementation of the identified standards for sound financial systems.
- A report was submitted to the FSF at its meeting in Singapore on 25–26 March 2000. The issues discussed included the following:
  - Key issues for fostering the implementation of standards, such as promoting country ownership, providing market and official incentives and mobilising resources through enhanced partnerships.
  - A five-stage strategy was designed:
    - i. Identifying and forging international consensus on 12 key standards;
    - ii. Prioritising standards for implementation;
    - iii. Designing and effecting an action plan to implement standards;
    - iv. Assessing progress in the observance of standards; and
    - v. Disseminating information on progress in the observance of standards.
- In addressing the key issues identified above, the FSF formed the Follow-Up Group on Incentives to Foster Implementation of Standards to explore issues related to market and official incentives in greater depth:

Market incentives: to raise general awareness of relevant standards and the benefits of observing them. This called for closer co-operation among the International Financial Institutions (IFIs) and standard-setting bodies, which should also be encouraged to enhance both the availability of information on observance of standards, and the presentation of Reports on Observance of Standards and Codes (ROSCs).

Official incentives: a three-prong approach outlining the incentives to be emphasised was proposed, as meeting all 12 key standards of the Compendium of Standards would be too demanding for many countries. These included the incentives aimed at:

- Encouraging economies to adopt standards and credible implementation plans; and
- Promoting market discipline, encouraging observance of relevant standards and disclosure of assessments.

development in 2000 was the international recognition (notably by the IMF, FSF and APEC) that adoption of international standards and codes would need to take into consideration the implementation capacity and specific circumstances of the country concerned.

While recognising the importance of greater transparency, Malaysia shared the concern among emerging market economy participants in the IMF's Special Data Dissemination Standards (SDDS) that the data requirements were being continuously augmented. This placed undue demand on the limited resources of subscribing countries. Moreover, the additional

data requirements often duplicated those already available in national web-sites. The IMF acknowledged the problem of resource constraints faced by countries and agreed that the SDDS should be reviewed from time to time. There was also a need to assess the usefulness of the SDDS to investors and analysts.

Malaysia's position on the activities of **Highly Leveraged Institutions (HLIs)** was also raised and the need for some form of regulation and monitoring of the activities of the HLIs was emphasised so as to avoid excessive volatility in financial markets. An issue of particular concern had been the large volume of funds available to



HLLs, which had highly destabilising effects on the relatively small foreign exchange and capital markets of emerging economies. Some progress had been made in terms of an international consensus on the indirect regulation of HLLs. On 22 February 2001, banks active in the global foreign exchange markets released a set of voluntary guidelines for good trading practice. This was in response to the recommendations by the FSF Working Group on HLLs, which included measures on the regulation of bank lending to HLLs, transparency requirements and adoption of industry codes of conduct by HLLs. These were aimed at strengthening the disclosure and transparency of HLL activities as well as the financial institutions' risk management and practices when dealing with the HLLs.

Malaysia, however, continued to emphasise the need for direct regulation of HLLs. This need was recognised by the FSF at its meeting in Singapore on 25-26 March 2000 and consideration was subsequently given by the international community (notably the IMF, FSF, APEC and ASEM) to the possibility of direct regulation of HLLs, should the proposed measures on indirect regulation prove to be ineffective.

In this connection, Malaysia's view on the need for a global mechanism to monitor and manage **capital flows** was also reiterated at meetings in 2000 so as to achieve an efficient functioning of the international financial markets and to minimise the risks of excessive volatility in international capital flows. Progress on this front was limited and fell short of Malaysia's recommendations. At the IMF, a Capital Market Consultative Group had been established to facilitate a better understanding of the dynamics of international capital markets and the operations of private financial institutions. It was envisaged that the Group would contribute to efforts to enhance IMF surveillance and facilitate the design of more appropriate policies on capital flows. In addition, on 1 March 2001, the IMF announced its decision to establish an International Capital Markets Department. This would help the IMF to fulfil its role as a centre of competence for the stability of the international financial system. The IMF had also conducted a survey on "High Frequency Monitoring of Positions and Transactions in Foreign Exchange Markets" to improve understanding of developments in these markets. Indeed, a recurrent theme during the IMF/World

Bank Annual Meetings in 2000 was the need for the IMF to undertake more detailed studies on capital flows. Malaysia remained sceptical of the merits of more studies being undertaken without any constructive and concrete proposal to ensure stable capital flows in financial markets. Hence, at the regional level, several initiatives had been launched, including the development of a regional co-operative mechanism to facilitate the exchange of information on capital flows among the SEACEN central banks, the Reserve Bank of Australia and the Hong Kong Monetary Authority. A similar exchange was also being discussed between ASEAN and the People's Republic of China, Japan and the Republic of Korea as part of regional surveillance among these countries.

Another significant development in 2000 was the growing international recognition of the need for appropriate sequencing in the liberalisation of **capital account transactions**. During the meetings of the IMF, APEC, G-15, ASEM and ASEAN, participants acknowledged Malaysia's concern that capital account liberalisation carried costs as well as benefits, and that the process should be properly sequenced, in tandem with the stage of development of the domestic financial system and supervisory framework. BNM also emphasised that countries should reserve the option to institute appropriate safeguards, including exchange controls, to address the risks of excessive volatility in capital flows. In 2000, there was greater recognition by the international community (notably the IMF, APEC, EMEAP and Manila Framework Group) of the merits of capital controls, although controls on inflows were viewed more favourably than controls on outflows. BNM would continue to urge the international community not to penalise countries for imposing capital controls when such prudential measures were required to restore stability in domestic financial markets.

The issue of the **choice of an appropriate exchange rate regime** continued to be the focus of discussions in international and regional fora in 2000. The international community acknowledged that there was no universal exchange rate regime that was appropriate for all countries at all times and countries should not limit their choice to "corner" solutions of a hard peg or independently floating exchange rate regimes. This was in contrast to earlier pronouncements,

## IMF Meetings in 2000

### I. International Monetary and Financial Committee (IMFC) Meetings in 2000

- 16 April, Washington D.C., USA
- 24 September, Prague, Czech Republic

### II. The Annual Meetings of the International Monetary Fund and World Bank

- 26-28 September, Prague, Czech Republic

### Issues Discussed

#### • World Economic Outlook

- Noted the strengthened global economic growth, which was the highest in 12 years.
- Expressed concern over the risks of high oil prices and high level of equity valuations in the G-3 area.

#### • Reform of the IMF

- Urged the IMF and the international community to strengthen efforts to reduce vulnerability and avoid crises.
- Noted the need to ensure that the benefits of freer trade and more integrated international capital markets reached both industrial and developing nations.
- Noted the need for the IMF to reform and adapt to the changing environment.
- Noted that the IMF should focus on its core areas of responsibility while continuing its collaboration with other agencies to strengthen co-operation and complementarity.
- Called for a review of IMF conditionality to ensure that it focused on the most essential issues, enhanced the effectiveness of IMF-supported programmes and paid due respect to members' specific circumstances and their implementation capacities.
- Welcomed the establishment of an independent evaluation office to improve the IMF's operations and accountability.
- Noted the on-going work of the quota formulae group and stressed that quotas should reflect developments in the international economy.

#### • Transparency and Accountability

- Reiterated the importance of greater transparency of governments and IFIs.
- Welcomed the establishment of an independent evaluation office, which would complement the IMF's on-going internal audit and self-evaluation activities.

#### • Efforts in Poverty and Debt Reduction in Poor Countries

- Welcomed the IMF's enhanced role in poor countries and endorsed the progress reports on the Heavily Indebted Poor Countries (HIPC) Initiative and Poverty Reduction and Growth Facility (PRGF), incorporating poverty reduction efforts as a key element of a new growth-oriented economic strategy for low-income members.
- Welcomed the establishment of a World Bank/IMF Joint Implementation Committee to facilitate implementation of the HIPC Initiative and the poverty reduction strategy process.
- Welcomed the proposal to bring 20 countries to their Decision Point by end-2000 to ensure debt relief was provided in the context of a strong commitment to growth and poverty reduction.
- Urged countries involved in the Initiative to expedite the preparation of Poverty Reduction Strategy Papers (PRSPs), integrating priority measures for poverty reduction and structural reforms.
- Stressed the importance of full participation by all creditors in the HIPC Initiative.



- **Private Sector Involvement**

- Noted the progress in developing a framework for involving private creditors in the resolution of crises, which would strike a balance between the clarity needed to guide market expectations and the operational flexibility needed to allow the most effective response in each case.
- Noted the importance of collective action clauses in crisis resolution and the need to treat different classes of private creditors equally.
- Endorsed the flexible approach used by the international community to deal with diverse cases based on the IMF's assessment of a country's underlying payment capacity and prospects of regaining market access.

- **Review of IMF Facilities**

- Noted the elimination of the Currency Stabilisation Fund, Support for Commercial Bank Debt and Debt Service Reduction, and Buffer Stock Financing Facility and the contingency element of the Compensatory and Contingency Financing Facility.
- Noted the modifications to the CCL to make it a more effective instrument for crisis prevention.
- Noted the changes to the terms of the Standby Arrangement and Extended Fund Facility (EFF) to avoid reliance on IMF resources for unduly long periods or in unduly large amounts. Use of EFF should be confined to cases where longer-term financing is clearly required.

- **Progress of Initiatives under IMF Surveillance Process**

- Noted that IMF surveillance should be strengthened further to identify vulnerabilities and anticipate threats to financial stability.
- Supported the analysis of vulnerabilities in its surveillance process.
- Urged the IMF to improve its multilateral surveillance by taking into consideration the international implications of national policies.
- Urged the IMF to undertake further work on exchange rate arrangements, the sequencing of financial sector development and capital account liberalisation, and the monitoring and analysis of developments in international capital markets.
- Endorsed the decision to expand the coverage of the Financial Sector Assessment Programme to 24 countries for 2001.
- Noted the importance of members providing information and adhering to the IMF's standards and codes.

- **Safeguard and Misreporting**

- Welcomed the adoption of a strengthened framework of measures to safeguard the use of IMF resources and to deter misreporting and misuse of IMF resources.

- **Exchange Rate Regimes**

- Noted that there is no single exchange rate regime that is suitable for all countries at all times.

notably by the IMF and some industrial countries, on the perceived advantages of more flexible exchange rate regimes. While countries should have the right to choose their own regime, the consensus was that countries should ensure that macroeconomic policies and institutional arrangements were consistent with the chosen regime. This was important to ensure the sustainability of the chosen regime. During the year, the international community

requested the IMF to undertake further work on exchange rate issues to provide the appropriate advice to its membership.

An additional dimension to the debate on exchange rates was introduced during the ASEM Finance Ministers' Meeting in January 2001. The Ministers observed that the corner solutions of free floating as well as fixed exchange rate regimes might not be the

panacea as both strategies carried costs. It was proposed that intermediate regimes such as band arrangements might be more appropriate for emerging market economies which sought to maintain some flexibility while avoiding excessive volatility in exchange rates.

While recognising the importance of implementing policies that were consistent with the chosen exchange rate regime, BNM also highlighted Malaysia's concern that sound domestic policies *per se* would not guarantee stability. Of particular concern was the risk of spill-over effects from excessive volatility in the Group of 3 (G-3) currency areas, namely, the US

evaluation office to ensure greater accountability by the IMF in its policy recommendations to members. IMF lending conditionalities had been reviewed to ensure that they focused on critical areas and took into consideration the country's implementation capacity. A significant development was the review of the IMF's Contingent Credit Line (CCL) facility to enhance its accessibility and effectiveness as an instrument for preventing crises and thereby avoid contagion effects. The interest rate surcharge and commitment fee on the CCL had been reduced, while automatic disbursement of the initial portion of funds was raised to one-third of the total credit line of a CCL facility.

The international community gave recognition to the need for appropriate sequencing of capital account liberalisation, and acknowledged that no specific exchange rate regime was appropriate for all countries, at all times – the choice of exchange rate regime should be supported by macroeconomic fundamentals and reflect country-specific circumstances.

dollar, Euro and Japanese yen. In this regard, BNM had emphasised that closer policy co-ordination among the G-3 countries was essential to reduce the risks of an abrupt and disorderly adjustment in foreign exchange markets. The conduct of IMF surveillance on the G-3 should be strengthened, with more attention on the systemic implications of the G-3 economic policies. In this regard, the G-3 countries needed to pay due cognisance to the global implications of their national policies to address domestic issues, particularly on emerging and developing economies.

Another issue on the global agenda in 2000 was the **reform of the IFIs**. Malaysia had consistently maintained that IFA reforms must include the reform of the IMF and other international and regional financial institutions. In particular, the IMF needed to enhance its own transparency and accountability, refocus on its core functions and avoid being too intrusive in its relations with its members. Reforms were also needed to enhance the IMF's diagnostic capabilities, in the light of the lessons from the Asian financial crisis. The IMF should resist the temptation to overload its lending programmes with issues that were not relevant to the problem at hand.

In this regard, some progress was made, particularly in streamlining IMF facilities as well as in setting up an independent external

There was also a consensus that the IMF should focus on three core issues: exchange rate arrangements; the sequencing of financial sector development and capital account liberalisation; and the monitoring and analysis of developments in international capital markets. The IMF was encouraged to deepen its work on international financial markets. In particular, IMF staff were urged to improve their understanding of market dynamics and cross-border capital flows. Such reforms were in line with the call of IMF Governors and the vision of the new IMF Managing Director to ensure that the IMF continued to be relevant to the changing needs of its member countries and the environment in which it operated.

While this progress was welcomed, more comprehensive reforms were required at the IMF. In particular, there was a need to ensure greater accountability by the IMF for its policy prescriptions. This could be achieved through allowing Asian countries a greater voice in the decision-making process at the IMF. In this regard, a speedy consensus on a new formula for IMF quota allocations was needed to better reflect developments in the world economic and financial system. In particular, there was an urgent need to ensure that IMF quota allocations with respect to emerging market economies

## Selected IMF Financial Facilities

### Contingent Credit Line (CCL)

Purpose: To provide a precautionary line of credit for member countries with sound economic policies that face balance of payments problems that may arise from international financial contagion.

Interest rate: SDR interest rate, plus surcharges of 150-350 basis points.

Disbursement: Automatic release of 1/3 of total credit line, with the balance upon agreement of an IMF adjustment programme.

Tenure: 1-1 1/2 years, with extension of up to 2-2 1/2 years.

### Supplemental Reserve Facility (SRF)

Purpose: Financial assistance to members facing exceptional balance of payments difficulties owing to a large short-term financing need resulting from a sudden and disruptive loss of market confidence.

Interest rate: SDR interest rate, plus surcharges of 300-500 basis points.

Disbursement: Phased on a quarterly basis, subject to observance of performance criteria and the completion of programme reviews.

Tenure: 1-1 1/2 years, can be extended to 2-2 1/2 years.

### Poverty Reduction and Growth Facility (PRGF)

Purpose: Provide long-term financial assistance to support medium-term macroeconomic and structural adjustment programmes in low-income member countries.

Interest rate: 0.5% per annum.

Disbursement: Three-year arrangements, subject to observance of performance criteria and the completion of programme reviews.

Tenure: 5 1/2 -10 years.

adequately reflected their changing economic positions in the world.

Overall, some progress had been made to strengthen the IFA in 2000. Nevertheless, much remained to be done and BNM would continue to emphasise the need for the international community to persevere with IFA reforms to

### *Financial Sector Liberalisation in the World Trade Organisation*

In 2000, work in the WTO mainly comprised the mandated negotiations in the agriculture and services sectors. This was because the Third Ministerial Conference of the WTO in Seattle (30 November-3 December 1999) did

In 2000, a new round of mandated services negotiations was initiated. However, the launch of a comprehensive round of trade negotiations in 2001 depends on agreement on a balanced agenda that reflects the interests of all members.

ensure that globalisation worked for the benefit of all countries. In the absence of comprehensive reforms, particularly in terms of international rules on capital flows, BNM would reiterate Malaysia's position that countries reserved the right to implement appropriate safeguards, including temporary capital controls, to curb excessive volatility of cross-border capital movements.

not reach a consensus to launch a comprehensive new round of trade negotiations, as member countries could not agree on a number of contentious issues such as investment, competition policy and labour. Subsequently, the APEC Leaders, at their Summit in Brunei Darussalam on 12-16 November 2000, agreed to expedite efforts to launch a new round of WTO trade

### The Newly Launched Services Negotiations

Unlike the ASEAN Free Trade Agreement which had a specific implementation deadline of 2003, the General Agreement on Trade in Services (GATS) did not have a specific deadline for the liberalisation of trade in services. The GATS instead provided for mandated negotiations in the services sector to take place every five years from the date of entry into force of the WTO Agreement in 1995, and periodically thereafter. This provision was to allow for a gradual and progressively greater liberalisation of the services sector.

The new round of services negotiations comprised two phases, namely:

- The "rules-making" phase where members negotiated new rules and disciplines relating to specific GATS provisions, including on subsidies, emergency safeguards and government procurement. The discussions also focused on the procedures and guidelines for the new round, scheduling guidelines and the disciplines on domestic regulation; and
- The "request and offer" phase where members would negotiate further liberalisation of the specific services sectors. Even though the "request and offer" phase was set to start after the completion of work in the "rules-making" phase, some members had proposed to start this phase of negotiations in March 2001.

negotiations in 2001. The APEC Leaders agreed to the proposal by Malaysia that the launch of a new round would be contingent upon a consensus on a balanced and broad-based agenda that would give due consideration to the interests and concerns of all members.

The new round of negotiations in the services sector, as mandated in the General Agreement on Trade in Services (GATS), was formally launched on 25 February 2000 by the WTO Council for Trade in Services. As a signatory to the financial services agreement under the GATS, Malaysia was committed to a gradual and progressive liberalisation of the financial services sector. BNM had been actively involved in the "rules-making" phase of the services negotiations, particularly in the negotiations to formulate

emergency safeguard measures (ESMs) for the services sector. BNM was involved in the discussions on the draft agreement on the ESMs prepared by ASEAN, which outlined the objectives, principles and elements of rules on ESMs for trade in services. The draft agreement on ESMs was presented as an ASEAN non-paper at the meeting of the Working Party on GATS Rules on 30 November 2000. Given the complexity of the issue, members agreed to further extend the deadline to conclude negotiations on ESMs by 15 months to 15 March 2002.

The groundwork for the "request and offer" phase of the services negotiations scheduled to begin in 2001 was still in progress. At the end of the last round of negotiations on financial services which was concluded in December 1997, Malaysia's offers reflected

### Emergency Safeguard Measures for the Services Sector

The negotiations on ESMs were part of a mandate contained in Article X "Emergency Safeguard Measures" of the GATS.

The purpose of having a safeguard mechanism was to allow members to temporarily protect their domestic services industry in the event that their WTO commitments cause or threaten to cause serious injury to the domestic industry. This was similar to the Agreement on Safeguards in the goods sector.

The envisioned ESMs include the suspension and/or modification of commitments made in the schedule of specific commitments.



current policies in the financial sector as well as substantial improvements in the insurance and offshore financial sectors. In particular, the maximum aggregate foreign shareholding in insurance companies was raised to 51% from 30% under certain conditions, while commitments were made to issue six new licences for life reinsurance and seven new licences for general reinsurance. In addition, as committed in the WTO, Malaysia raised the maximum foreign equity limits in stockbroking and financial leasing companies to 49% from 30% effective 1 July 2000. With effect from 1 December 2000, Malaysia implemented an earlier commitment to increase the maximum total credit facilities that could be obtained by the non-resident controlled companies from foreign-owned banking institutions from 40% to 50%. Unlike a number of the Asian countries, Malaysia did not raise the foreign equity limit in the banking sector in response to the Asian crisis. Malaysia already had a relatively high level of foreign participation in the banking sector compared to other Asian economies. There were 14 commercial banks

framework to absorb the changes and risks posed by a more liberal environment. Currently, the focus is on capacity building to strengthen the domestic financial institutions to enable them to face greater competition in a more liberalised environment in the future. In this regard, BNM has focused efforts on strengthening the regulatory and supervisory framework to further enhance the resilience and competitiveness of the financial system as well as to enhance corporate governance in the banking system.

### *Regional Co-operation Initiatives*

#### **ASEAN Financial Co-operation**

BNM participated in several important initiatives to further strengthen regional co-operation in 2000. At the ASEAN level, BNM co-ordinated the successful expansion and enlargement of the ASEAN Swap Arrangement (ASA), a long-standing tradition of ASEAN financial co-operation to provide temporary balance of payments and liquidity support to its members in times of need. In its role as the Agent Bank for the ASA for 2000-2002,

Regional financial co-operation strengthened in 2000; the ASEAN Swap Arrangement was expanded to US\$1 billion and discussions began on an ASEAN+3 network of bilateral swap arrangements under the Chiang Mai Initiative.

that were 100% foreign-owned in Malaysia. Overall, foreign banking institutions in Malaysia accounted for about 25% of the banking sector's market share in terms of total assets and total deposits as at end-2000.

During the up-coming "request and offer" phase of the services negotiations, Malaysia could expect to receive requests from partner countries to further liberalise the financial sector. Malaysia would continue to observe the policy of progressive liberalisation of the financial sector with emphasis on ensuring that liberalisation should offer benefits to the Malaysian economy and not jeopardise stability in domestic financial markets. In this regard, the pace of liberalising the banking and insurance sectors would be determined by the path charted in the Financial Sector Masterplan. The strategy is to adopt a gradual and progressive approach to liberalisation, consistent with the country's economic needs and the capability of the existing financial infrastructure and regulatory

BNM facilitated the consensus to expand membership in the ASA to include all ASEAN member central banks and monetary authorities, and to enlarge the size of the ASA to US\$1 billion. The expanded ASA represented an important ASEAN contribution to regional initiatives to promote self-help and support mechanisms.

During the year, an ACBF Task Force was established to evaluate the feasibility, preconditions and merits of an ASEAN Common Currency and Exchange Rate Mechanism. Although there had been no commitment thus far on a single currency for ASEAN, early work in this area was part of the long-term programme of ASEAN financial co-operation. Finance Ministers and Leaders felt that it would be useful to identify the preconditions, costs and benefits of a common currency in ASEAN. A better understanding of the issues involved would facilitate discussions and the adoption of appropriate measures among ASEAN members

## ASEAN Central Bank Forum Meetings in 2000

- I. 6th ACBF, Brunei Darussalam, 22 March
- II. 7th ACBF, Brunei Darussalam, 21 August

### Issues Discussed

- **Peer Review:** While the economic performance of the ASEAN countries had improved in 2000, downside risks included higher oil prices, depreciation of regional currencies, as well as uneven pace of restructuring of the corporate and banking sectors. Members exchanged views on measures implemented to develop domestic capital markets to ensure deep and highly liquid financial markets, as well as diversifying the sources of funding.
- **Progress and Issues in Complying with the New Requirements of the IMF Special Data Dissemination Standard (SDDS):** Members agreed that the ACBF could provide a useful forum to exchange information or address concerns regarding the IMF SDDS requirements. While most ACBF members, including BNM, have complied with the new SDDS templates on reserves and external debt, concerns on the demands of these requirements would be conveyed to the IMF.
- **Review of the ASEAN Swap Arrangement:** Members agreed that the facility be enlarged to US\$1 billion and that its membership be expanded to include ten ASEAN members. Features of the Arrangement would also be modified/adjusted to reflect the current environment.
- **ASEAN+3 Bilateral Swap Arrangement and Repurchase Agreement (BSA) under the Chiang Mai Initiative:** Members exchanged views on the proposed terms and conditions of the ASEAN+3 BSA.
- **ASEAN Common Currency and Exchange Rate Mechanism:** Members agreed to set up a task force, to be chaired by BNM, to undertake a Feasibility Study on an ASEAN Common Currency and Exchange Rate Mechanism.

that would be required to meet this long-term objective.

### ASEAN+3 Financial Co-operation

Another important development in regional co-operation in 2000 was the inaugural meeting of the ASEAN+3 Finance Ministers, which provided a forum for more effective dialogue and co-operation between ASEAN Finance Ministers and their peers from the People's Republic of China, Japan and the Republic of Korea (the +3 countries). BNM's participation in this forum focused on the development of the Chiang Mai Initiative (CMI), a regional financial support network under the aegis of the ASEAN+3 Finance Ministers' Process.

The CMI was launched on 6 May 2000 to strengthen regional self-help and support mechanisms in East Asia to supplement the existing international facilities. The CMI would comprise two components, namely, an expanded

ASA, and a new network of bilateral swap arrangements and repurchase agreements (BSA) between ASEAN and the People's Republic of China, Japan and the Republic of Korea.

The objective of the CMI was to enable countries to pool their resources and channel financial assistance to countries facing short-term liquidity needs and hence, avert potential crisis and contagion effects.

The **expanded ASEAN Swap Arrangement** took effect on 17 November 2000, with BNM as the Agent Bank to co-ordinate the operations and administration of the ASA (Details in the box on ASEAN Swap Arrangement).

The **ASEAN+3 Bilateral Swap Arrangements and Repurchase Agreements (BSA)** comprise a nexus of bilateral swap arrangements and repurchase agreements between ASEAN and the +3 countries. An ASEAN+3 Finance and Central

## ASEAN Swap Arrangement

### Background

At the 6th Meeting of the Special Committee of ASEAN Central Banks and Monetary Authorities in Kuala Lumpur on 15 January 1977, the ASEAN Governors agreed to establish an ASEAN Swap Arrangement (ASA) to provide unconditional and immediate short-term liquidity assistance for emergency foreign exchange financing to members facing temporary international liquidity problems.

On 5 August 1977 in Kuala Lumpur, the ASA Memorandum of Understanding was ratified for an initial one-year period with a total facility of US\$100 million between the central banks of Indonesia, Malaysia, the Philippines, Thailand and Monetary Authority of Singapore. The total amount available was increased to US\$200 million in 1978. To co-ordinate and administer the facility, members took turns (in alphabetical order) to become the Agent Bank.

Since its inception in 1977, the ASA had been renewed eight times, between 1979 and 2000. The last renewal, the Eighth Supplementary Agreement to the Memorandum of Understanding to the ASA, was ratified on 27 January 2000 for a one-year period, pending a comprehensive review of the facility to ensure that the facility remained relevant to members' requirements.

### The Expanded ASA

The Asian financial crisis had highlighted the need to review the facility to respond to the needs of its members in a changed global financial environment. In addition to changes in the financial landscape, the review was also timely given that the membership of ASEAN had expanded to ten South-East Asian countries. At the 7th meeting of the ASEAN Central Bank Forum (ACBF) on 21 August 2000, work was initiated to enlarge the size of the facility to US\$1 billion and to expand the membership of the ASA to include Brunei Darussalam, Cambodia, Lao P.D.R., Myanmar and Vietnam.

In November 2000, the ASEAN central banks, the Monetary Authority of Singapore and the Ministry of Finance of Brunei Darussalam, signed a Memorandum of Understanding on the new and enlarged ASA. Currently operational, the ASA would be available for a period of two years, subject to renewal upon mutual agreement by the participating members. In line with this extension, the tenure of the appointed Agent Bank was increased to two years to co-ordinate the operations and administration of the ASA.

### The Swap Mechanism under ASA

Financial assistance under ASA involves the spot selling of a participant's domestic currency, combined with a forward repurchase of that currency against US dollars, Japanese yen or the Euro. A member's request to swap its domestic currency for US dollars, Japanese yen or Euro will be for an amount of up to twice its committed amount under the ASA and for a period of up to six months. In line with its role as a rapid disbursement facility, a member's swap request for temporary liquidity or balance of payments assistance will be confirmed through the Agent Bank, which will inform and consult with the other members to assess and process the request (as expeditiously as possible). It is expected that disbursements could be made within seven business days.

The expanded and enlarged ASA represents an important step forward in enhancing financial co-operation among ASEAN member countries. The ASA will also play a key role in efforts to develop and strengthen regional self-help and support mechanisms, including the Chiang Mai Initiative.

### ASEAN and ASEAN+3 Finance Ministers' Meetings in 2000

- I. 4th AFMM, 25-26 March, Brunei Darussalam
- II. 2nd Special AFMM, 25 September, Prague, Czech Republic
- III. 1st AFMM+3, 6 May, Chiang Mai, Thailand
- IV. 2nd AFMM+3, 25 September, Prague, Czech Republic

#### Issues Discussed

- Peer Review: Ministers welcomed the stronger-than-expected recovery of member economies and agreed to strengthen policy dialogues and regional co-operation activities in the area of capital flows monitoring, self-help and support mechanism and international financial reforms.
- ASEAN Finance Co-operation: Ministers observed the progress made in various regional finance co-operation activities to sustain economic recovery, including capital market development.
- East Asia Finance Co-operation: Ministers noted the progress in the revisions to the ASEAN Swap Arrangement and the Bilateral Swap Arrangement and Repurchase Agreement proposed under the Chiang Mai Initiative. Ministers requested further studies on other appropriate regional financing arrangements in ASEAN+3 that could provide sufficient and timely financial support to ensure regional financial stability.
- Monitoring of Capital Flows: Ministers noted the development of co-operation in monitoring capital flows in ASEAN+3, in particular, the meeting of experts at the Workshop on Monitoring Capital Flows in ASEAN+3 in April 2000. In addition, it was agreed that ASEAN+3 would use the existing framework to facilitate the exchange of information on capital flows. Ministers also agreed to establish a network of contact persons to facilitate regional surveillance in East Asia to enhance the effectiveness of economic reviews and policy dialogues.
- International Financial Architecture: Ministers noted developments in the G-7, G-20 and the FSF in 2000.

Bank Deputies' Meeting (AFDM+3) Working Group comprising senior officials from finance ministries and central banks was established to look into the modalities and operational details of the proposed BSA. The Working Group met twice in 2000, in Bangkok, Thailand on 22 October, and in Beijing, the People's Republic of China on 6-7 November.

#### SEACEN

During the year, BNM continued to support the activities of the SEACEN Research and Training Centre, in particular, its efforts to enhance its role as a leading centre for research and training in central banking and financial supervisory matters. In this connection, several SEACEN activities were hosted in Kuala Lumpur, notably the SEACEN Governors' Conference in January 2000 and

collaborative training programmes between the SEACEN Centre and various multilateral organisations and regional institutions.

In terms of expanding its collaborative programmes, the SEACEN Centre forged strategic alliances with, among others, the IMF, the World Bank, BIS and the Toronto Centre. To further share experiences and expertise among the central banking fraternity, the SEACEN Centre's training activities continued to draw its resources from member central banks and monetary authorities as well as from other central banks such as the U.S. Federal Reserve System and the Bank of England. In pursuing collaborative training programmes with international and regional financial institutions, the SEACEN Centre's training activities emphasised actual skills and practical working

## SEACEN Programmes hosted by BNM in 2000 – 2001

### Conferences/Meetings

- 35th SEACEN Governors' Conference and 19th Meeting of the SEACEN Board of Governors, 27 – 28 January 2000

### Training Courses

- SEACEN-IMF Course on Macroeconomic Adjustment and Financial Sector Issues, 30 October – 10 November 2000

### Seminars

- SEACEN-Toronto Centre Leadership Seminar for Senior Management of Central Banks, 24 June 2000
- The Impact of Electronic Banking and E-Commerce on Central Banking Functions, 9 – 11 January 2001

tools as part of the Centre's niche in providing quality training.

SEACEN had also started work on the Strategic Review Project, which would chart the future direction of the Centre and explore ways for it to meet more effectively the needs of its members. The Project would identify measures/changes and a range of activities that would enhance SEACEN's status as an internationally recognised research and training institution for central banks. The Project was funded by the Japanese Technical Assistance Programme under the IMF and was targeted to be completed by June 2001.

A significant development in 2000 was the enhancement of collaboration between SEACEN and the BIS and other international institutions and fora. As part of SEACEN's programme to further enhance co-operation among central banks and monetary authorities, an experts group on capital flows was set up in 2000. The SEACEN Experts Group on Capital Flows (SEG) was set up in response to the request by the SEACEN Governors for the SEACEN Centre to assume a more effective role in promoting regional financial co-operation. Participation included SEACEN member banks, the Reserve Bank of Australia and the Hong Kong Monetary Authority, while technical support was provided by the SEACEN Centre. The objective of the SEG was to develop a regional framework to promote information-sharing on capital flows. The SEG aimed to draw up concrete and practical proposals that members could implement individually or collectively to enhance the management of capital flows.

The SEG had met twice, on 29 May in Kuala Lumpur, and on 6 September in Ulaanbaatar, Mongolia. Early work included the design of a common data template and a list of contact persons to facilitate the exchange of information on capital flows among SEG members. The SEG also discussed the latest trends and issues, including underlying factors influencing capital inflows and outflows in individual member countries; problems of data capture, particularly those related to private sector flows; and the difficulty in differentiating between trade-related and non-trade-related flows. The SEG initiative was co-chaired by BNM and Bangko Sentral ng Pilipinas.

### Asia-Pacific Economic Co-operation (APEC)

During the year, APEC co-operation in finance focused on the need to better manage the challenges of globalisation. In this regard, APEC Finance Ministers agreed to enhance technical co-operation to assist member economies in capacity building. To meet APEC's long-term objectives to assist member economies to strengthen the foundations for sustainable growth in the region, several initiatives were launched to enhance financial and capital market development.

BNM participated as a core group member in the **Voluntary Action Plan (VAP)** to Support Freer and More Stable Capital Flows in the APEC Region. The VAP's aims were to enhance members' understanding of the benefits and risks associated with cross-border capital flows as well as to focus on the development and implementation of

## Asia-Pacific Economic Co-operation (APEC) Meetings in 2000

- I. APEC Finance and Central Bank Deputies' Meeting
  - 16–19 April, Washington D.C., USA
  - 9–10 September, Brunei Darussalam
- II. APEC Finance Ministers' and Informal Leaders' Summit
  - 12–16 November, Brunei Darussalam

### Issues Discussed

- **Managing Globalisation:** Recognising that globalisation increased economies' susceptibility to external shocks and social dislocation, APEC reiterated the need for robust institutions and well-trained people to ensure that opportunities were fully exploited. The emphasis going forward was to better manage the adverse impact of globalisation, in particular to deliver higher living standards and social well-being to communities. There was greater resolve to address the wide disparities in wealth and knowledge through APEC's economic and technical co-operation programmes to assist member economies to build the necessary capacity.
- **Forging a Stronger Global Financial System:** APEC welcomed international efforts in reducing financial panic through greater international surveillance, strengthening the regulatory and supervisory framework as well as appropriately involving private creditors in crisis resolution. There was acknowledgement for necessary reforms to the IFIs including the review of IMF quotas to reflect developments in the world economy.

Other regional financing arrangements were also recognised as potentially effective in crisis prevention and resolution, by complementing the resources provided by various IFIs.

- **Building Stronger Foundations:** APEC's long-term objective was to build stronger foundations for sustainable growth in the region by further developing financial and capital markets. In order to meet this objective, APEC had developed several initiatives designed to strengthen APEC's capacity building efforts. Malaysia participated in three initiatives: Voluntary Action Plan (VAP); Bank Failure Management Initiative; and Financial Regulators Training Initiative.

policies to maximise the benefits and minimise the risks. BNM presented Malaysia's experience with managing capital flows and the policies taken to strengthen the domestic financial system. Recent experience had demonstrated the economic difficulties arising from radical shifts in cross-border capital flows in the absence of international rules on capital flows. Malaysia's approach, therefore, underscored the need for countries to have the flexibility to implement appropriate mechanisms at the national level to curb the excessive volatility of cross-border capital movements. As the current international financial environment had created greater financial market volatility and economic uncertainties, Malaysia's experience demonstrated that selective and carefully designed measures, that complemented pragmatic macroeconomic policies, could contribute to stability.

In the policy dialogue section of the VAP report, BNM supported the implementation of key international financial standards and codes in order to promote sound, efficient and stable financial markets in the region. However, BNM would continue to emphasise the need to give due cognisance to the concerns and constraints faced by emerging market economies, including Malaysia, in complying with increasingly onerous standards and codes.

BNM was also a member of the core group in APEC's latest initiative on **Bank Failure Management**. The initiative sought to study and draw lessons from economies' experiences in managing financial sector distress. Meanwhile, under the **Financial Regulators' Training Initiative**, APEC together with the SEACEN Centre and Asian Development Bank had, since

## Asia–Europe Meetings (ASEM) in 2000–2001

- I. 3rd ASEM Leaders' Summit, 19–21 October 2000, Seoul, Korea
- II. ASEM Finance Deputies' Meeting, 15 December 2000, Tokyo, Japan
- III. 3rd ASEM Finance Ministers' Meeting, 13–14 January 2001, Kobe, Japan

### Issues Discussed

- Noted the progress of the Chiang Mai Initiative in strengthening Asian financial co-operation, and efforts by the ASEAN+3 countries to strengthen regional policy dialogues and enhance regional surveillance.
- Noted that there was no single exchange rate arrangement that was appropriate for all countries under all circumstances. In determining the appropriate exchange rate regime, countries could choose from a spectrum of exchange rate arrangements, including intermediate regimes such as band arrangements, depending on country specific circumstances.
- Supported international efforts to counter money laundering activities through the ASEM Anti-Money Laundering Initiative.
- Welcomed technical assistance through ASEM initiatives such as the ASEM Trust Fund and the European Financial Expertise Network (EFEX) to strengthen financial systems. The ASEM Trust Fund II would be launched to encourage dialogue among policy makers from Asia and Europe.
- Endorsed the “Kobe Research Project” to facilitate inter-regional co-operative research and study activities on topics of mutual interest amongst its members.

1998, implemented training seminars for financial regulators, banking supervisors as well as securities regulators to improve domestic training as well as to enhance international co-operation in such training programmes. Under Phase II of the initiative, BNM was actively involved in the APEC Bank Supervisors' Advisory Group, and provided technical as well as logistical resources for regional courses and fora, notably the annual meeting of SEACEN/APEC Conference of Directors of Supervision.

### Asia–Europe Meeting (ASEM)

BNM continued to obtain technical assistance from ASEM through the **ASEM Trust Fund** for two projects. The Early Warning System Project would increase the capacity to monitor financial institutions, while the second project would study issues related to depositor protection. The implementation process of the technical assistance began in August 1999 and technical assistance to facilitate work on early warning systems was ongoing. With regard to the deposit insurance scheme, BNM hosted a seminar on 19

January 2000 to discuss the various options on the scheme.

### EMEAP

BNM remained actively engaged in the EMEAP process, as it represented an important forum for monetary and financial co-operation among central banks in the East Asia and Pacific region. The EMEAP Deputies met twice in 2000 (18 March in Hong Kong and 27 October in Bangkok), while the Governors' meeting was held in Seoul on 7 July 2000.

New initiatives under the EMEAP process included the launch of a Regional Foreign Exchange Markets Monitoring Meeting in 2000. Its aim was to provide an opportunity for relevant officials from member central banks to interact and exchange views on foreign exchange matters among themselves as well as with officials of other institutions such as the U.S. Federal Reserve Bank and the BIS.

In contributing to efforts to facilitate a better understanding of exchange rate issues, BNM

participated in three joint EMEAP studies in 2000. These studies were on Experience and Practical Issues Concerning Foreign Exchange Operations; Assessment of Foreign Exchange Rate Misalignments; and The Capital Account and Exchange Rate in Monetary Policy Decision Making.

During the year, BNM also participated in the activities of the three EMEAP working groups. These included the Working Group on Banking Supervision which involved a self-assessment on compliance with the Six Guidance Notes of the Working Group in dealing with problem loans. BNM discussed its experience in moving towards a risk-based supervisory approach, stress tests as well as Minimum Guidelines on Credit Risk Management.

The work of operational issues in managing capital flows was one of the projects under the Working Group on Financial Markets. In the Working Group on Payment and Settlement Systems, BNM took part in a survey to assess

In matters relating to the international financial system, the Group shared the views of other international fora that the choice of exchange rate regimes should be determined by individual country circumstances and supported by appropriate macroeconomic, structural policies and institutional arrangements. The Group also discussed the progress in the review of IMF financial facilities.

### *Bilateral Co-operation*

#### **Bilateral Payments Arrangement (BPA)**

In 2000, BNM continued to promote Bilateral Payments Arrangements (BPAs) as part of Malaysia's efforts to strengthen South-South trade and co-operation with other central banks. Such efforts were also in line with the Government's policy to diversify Malaysia's export markets to include non-traditional destinations.

By definition, a BPA is a settlement system for monetary obligations arising from trade between

**Inter-central bank technical support through attachment programmes focused on bank supervision, payments system, restructuring issues and data compilation. Malaysia also actively promoted the BPA to enhance South-South trade and diversify Malaysia's export markets.**

foreign exchange settlement risks. Two major themes in EMEAP's discussions in 2000 included the effectiveness of monetary policy during the Asian recovery, and monetary policy in a world of increased capital flows.

#### **Manila Framework Group**

The Manila Framework Group of Finance and Central Bank Deputies (MFG) met twice in 2000 (20-21 March 2000, Hong Kong and 3-4 December 2000, Bangkok). As in the previous year, the Group focused its discussions on regional surveillance and issues affecting the international financial system. On regional surveillance, the Group noted that while there was strong growth in Asia, indicators pointed to a gradual slowdown. Risks included high oil prices, a slowdown in the U.S. economy, and weak capital and financial market sentiment. The Group emphasised the need to make further progress in corporate debt restructuring. Looking ahead, the Group also discussed the issue of the adequacy of international reserves and the choice of growth strategies.

pairs of countries. Effectively, this arrangement converts the commercial risks relating to trade into a sovereign risk as the central banks of both countries guarantee payments in domestic currencies to their respective exporters. Hence, the BPA facilitates growth in trade between its signatory central banks despite foreign exchange reserve constraints. Over the years, the BPA had proven to be an important catalyst in promoting trade with South countries. In the past, such trade had been hampered not only by foreign exchange constraints but also a lack of trade information, limited banking relations and business contacts.

Since its inception in 1987, a total of 31 BPAs had been executed by BNM. The BPAs had resulted in a significant increase in Malaysia's trade with non-traditional markets to RM26.7 billion in 2000 from RM2.4 billion in 1987. Notwithstanding the relatively small proportion of BPA-related trade to Malaysia's total trade, the BPA played a catalytic role in trade expansion.



The experience had been that trade under BPAs would increase in the initial stages. As traders became more familiar with their trading partners, the tendency was for traders to “graduate” to the normal trade and banking channels (which had become more established). In the process, trade conducted under BPAs would decline. In this regard, the success of the BPAs was also reflected in the significant number of correspondent banking relationships established under the BPA (287 since 1987).

### **BNM Technical Assistance and Information Exchange**

As part of the Bank’s out-reach programme, BNM continued to provide technical assistance to foreign public and private sector institutions in 2000. The assistance was in the form of training programmes, study visits and briefings on various aspects of central banking in Malaysia.

In line with the Bank’s policy to promote co-operation among central banks, BNM offered 10 places at the BNM Central Banking Course (CBC) to foreign participants under the Malaysian Technical Co-operation Programme in 2000. The CBC was an intensive, three-week programme and covered the practical aspects of monetary and financial issues. The foreign participants in 2000 came from the central banks of Bosnia and Herzegovina, Botswana, Cambodia, Guinea, Indonesia, India, Iran, Iraq, Kyrgyz Republic and Sudan.

During the year, the Bank received 37 foreign delegations for study visits and attachment programmes. The delegations were from Albania, Bahrain, Bhutan, Brunei Darussalam, Czech Republic, Cuba, Egypt, India, Indonesia, Iran, Kazakhstan, Malawi, Mongolia, Nigeria, Peoples’ Republic of China, Republic of Uganda, Sri Lanka, Turkmenistan, Thailand, Uzbekistan, Vietnam and Zimbabwe. In response to specific requests, BNM was involved with study groups on Malaysia’s experience in various aspects of central banking, including bank supervision, bank regulation, economics, exchange control, investment and treasury operations, monetary and financial policy, currency management and operations and Islamic banking. BNM also received visitors from Australia, Austria, European Parliament, Finland, France, Hong Kong, SAR, China, Japan, Singapore, Switzerland

and the United Kingdom. The meetings provided an opportunity to discuss developments in the Malaysian economy and the financial system and the policy initiatives that had been taken.