Hong Kong Monetary Authority and Bank for International Settlements

Joint Conference on "The price, real and financial effects of exchange rate"

28-29 August 2017, Hong Kong

Opening Remarks by Mr. Arthur Yuen

Deputy Chief Executive, Hong Kong Monetary Authority

1. Good morning ladies and gentlemen. It is my great pleasure to welcome you to this one-and-a-half-day conference, jointly organised by the Bank for International Settlement (BIS) and the HKMA. I would like to especially thank our international guests who have travelled a long way to be with us today.

2. This is an annual research conference of the BIS Asian office. It will showcase a number of high-quality papers representing collaborative efforts between leading academics and BIS economists. The HKMA is very honored to host such an important and interesting conference this year. We would also present our work and participate in the discussion.

3. The theme of today's Conference is "The price, real and financial effects of exchange rate". Since the collapse of the Bretton Woods System of fixed exchange rates in the early 1970s, the importance of understanding exchange rate movement and its international spillover has increased enormously. This was followed by an explosion of cross-border trade

and capital flows in recent decades, driven by globalistion and the liberalisation of capital accounts.

4. In line with these trends, the thinking and understanding of the role and nature of exchange rate have evolved substantially since the 70s. Exchange rate was initially thought of as one that reflects and responds to changes in macroeconomic fundamentals, and acts as a buffer when the economy was hit by an external shock. Through these lenses, exchange rate was initially perceived to be more like an automatic stabiliser, responding and adjusting to external shocks and imbalances, rather than being a source of instability itself. Unfortunately, we subsequent saw repeated wild swings, herding behaviour and persistent misalignment of exchange rates. These experiences, together with numerous episodes of currency crises ranging from speculative attacks against Asian currencies in 1997 to the collapse of the Icelandic Krona in 2008, have since led to a re-think of the nature and role of exchange rate, away from being just a shock absorber.

5. The idea that exchange rate itself can be a source of exogenous and destabilising force to the economy meant that it is also important to understand the impact and transmission of exchange rate movement to the real economy. Against the rapidly changing global macro-financial environment, indeed our thinking on the transmission channel and effect

of exchange rate has evolved, from the relatively simplified perspectives of impact through trade, capital flows and Uncovered Interest Parity (that reflects interest rate differentials) to the recent more sophisticated view of transmission through the financial channels, for example, through the balance sheet effects and risk-taking behaviour.

6. Today, the increasingly integrated global financial markets, abundant global liquidity since the GFC, and large and volatile international capital flows mean our understanding of such financial channels of exchange rate impact transmission is particularly important for thinking about macro-financial vulnerabilities that have built up in recent years. We should also try to understand better the benefits of using prudential measures to address at least some of those vulnerabilities, particularly across emerging Asian economies.

7. Following the GFC, emerging Asia has seen large capital inflows, currency appreciation as well as rapid build-up of leverage and expansion of credits. To what extent that some of these financial imbalances had the effects of loosening domestic financial conditions, for example, through the balance sheet of borrowers with foreign currency liabilities? This would have implications on how the eventual capital outflows and the associated currency depreciation may pose risks of amplifying the unwinding of leverage and credits in the region.

8. If large capital outflows eventually causes volatile exchange rate movement, then is there a role for some form of policy measures, be that prudential measures, capital control or foreign exchange market intervention, that could mitigate both the ex-ante build-up and the later unwinding of imbalances? Answers to these questions would carry significant economic and policy implications in the face of current global economic challenges. At this juncture of the 10th anniversary of the GFC, and with global financial conditions beginning to normalise, this conference provides a very timely opportunity for policymakers to think about our understanding of the role of exchange rates as well as the potential policy challenges.

9. Ladies and gentlemen, I believe we all agree that there are many important and challenging issues to be discussed at this conference. I am sure everyone is looking forward to the presentation by many of the distinguished speakers and the dialogue during the policy panel session tomorrow. I hope that this Conference will contribute useful insights, and wish you all very fruitful discussion in these two days. Thank you.