

AN OVERVIEW OF INTERNATIONAL MONETARY SYSTEMS AND RECENT DEVELOPMENTS IN INTERNATIONAL FINANCIAL MARKETS

An Overview of International Monetary Systems

Recent Developments in International Financial Markets

- Nominal Exchange Rates
 - Patterns or random-walk behavior?
 - Constant or time-varying volatility?
- Real Exchange Rates
 - Random behavior or mean reversion?
 - Different ways to calculate real exchange rates
- Nominal Interest Rates
 - Patterns through the business cycle and across countries
 - Interest differentials versus the US\$ and versus the DM
- Real Interest Rates
 - Different ways to calculate real interest rates
 - Real interest rate differentials

Recent Developments in Emerging Market Currencies

- See the Merrill Lynch Currency and Bond Markets WWW page at <http://www.merrill-lynch.com/cicg/research/cbmt/index.htm> for current analysis of many markets and financial indicators
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An Overview of International Monetary Systems

"... the way in which an international monetary system actually works may differ enormously from the written or intended rules in the treaty on which it is apparently based." Ronald I. McKinnon, (1993, p. 2).

The "Rules of the Game" in International Finance

- Sometimes an explicit set of laws or regulations
- Sometimes an implicit set of conventions or customs
- The "rules of the game" represent the major operating principles of an international financial system, including
 - the conduct of domestic monetary policy (independent or dependent)
 - the conduct of exchange rate policy (intervention or not)
 - use of international reserves for exchange market intervention, or balance of payments smoothing
 - criteria for changing an exchange rate

Why Rules are Needed Within an International Monetary System

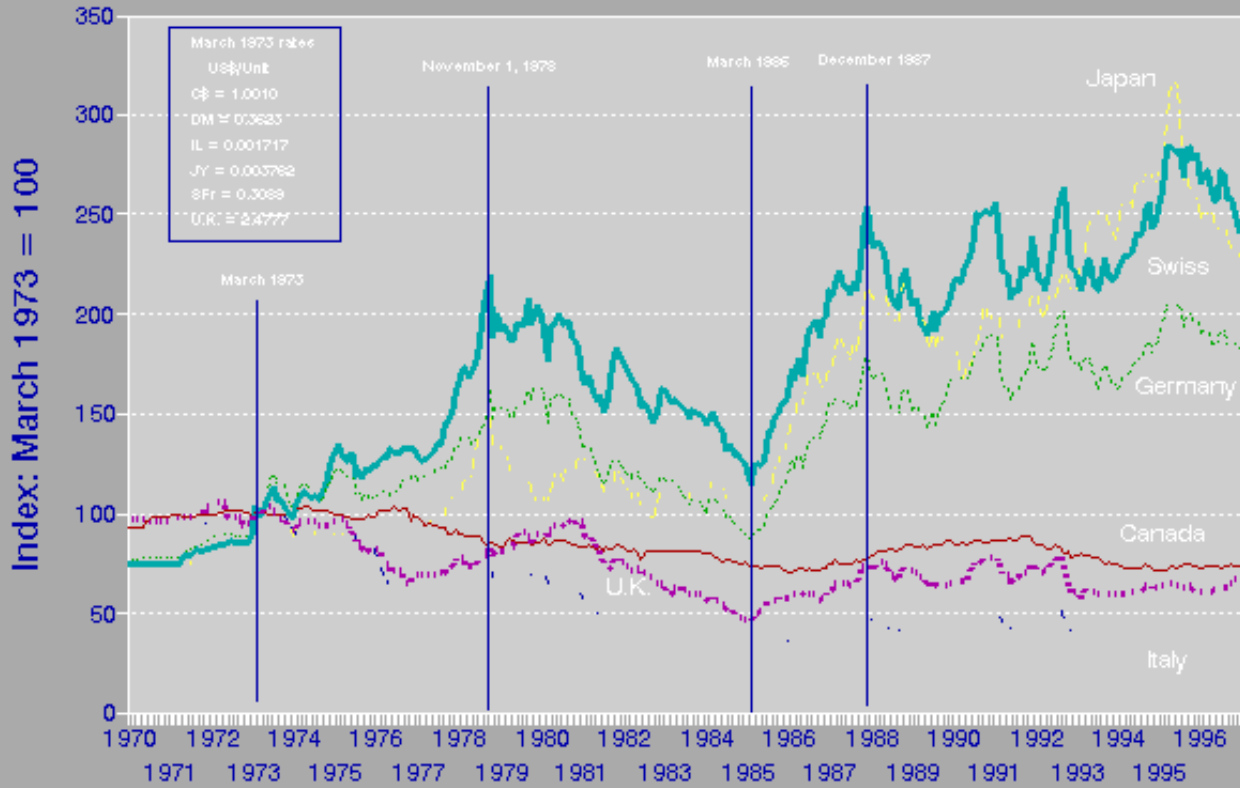
- Because the international economy is integrated, harmful spill-over effects (externalities) are possible
 - Costly resource misallocation, slower growth, excess unemployment
 - Costly to domestic consumers and investors
 - Costly to foreign consumers and investors
 - Costly to this generation and/or future generations of consumers/investors

The Main International Monetary Systems

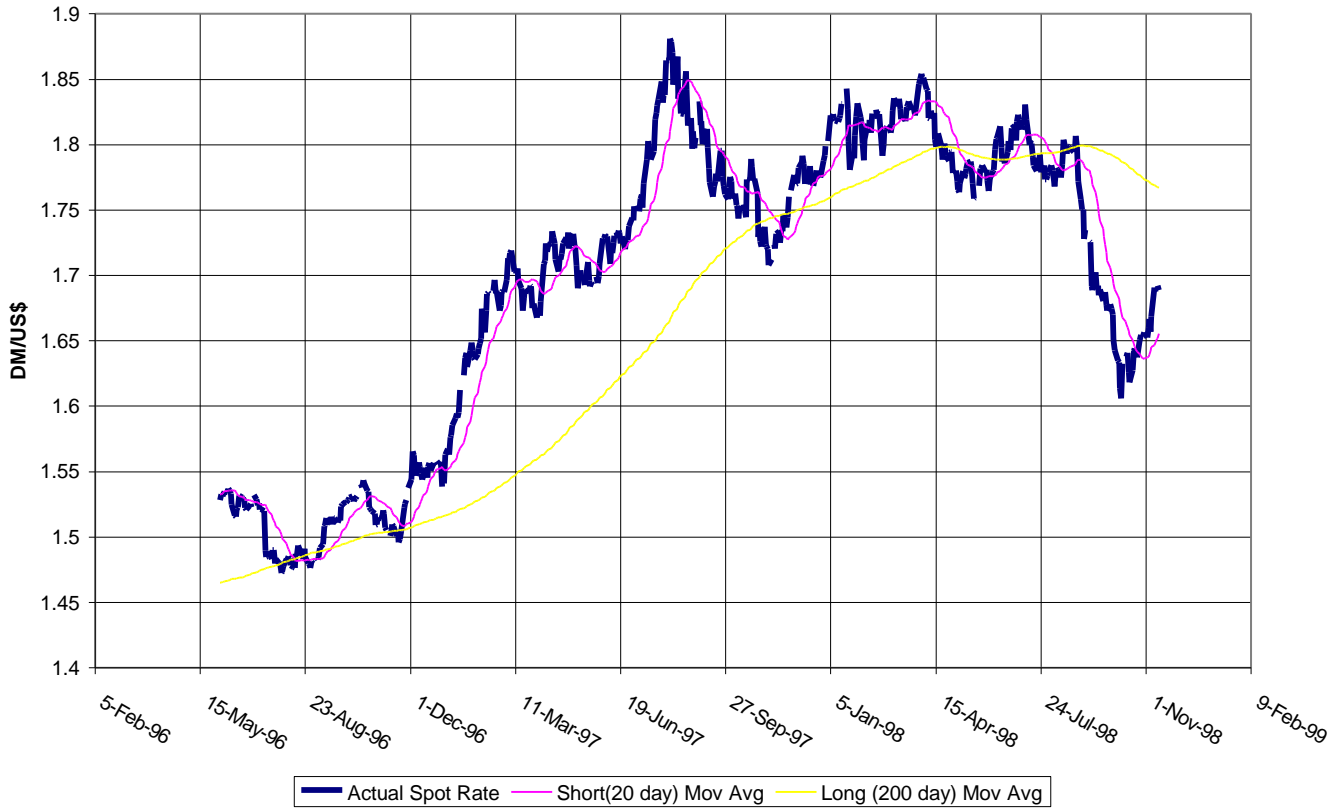
1. The International Gold Standard, 1879-1913
 - Currency Boards in the 1980s and 1990s
2. The Spirit of the Bretton Woods Agreement, 1945
3. The Fixed-Rate Dollar Standard, 1950-1970
4. The Floating-Rate Dollar Standard, 1973-1984
5. The Plaza-Louvre Intervention Accords and the Floating Rate Dollar Standard, 1985-1992
6. The Spirit of the European Monetary System, 1979
7. The European Monetary System as a "Greater DM" Area, 1979-1992

Figure 2.4

Spot Exchange Rates January 1970 - December 1996



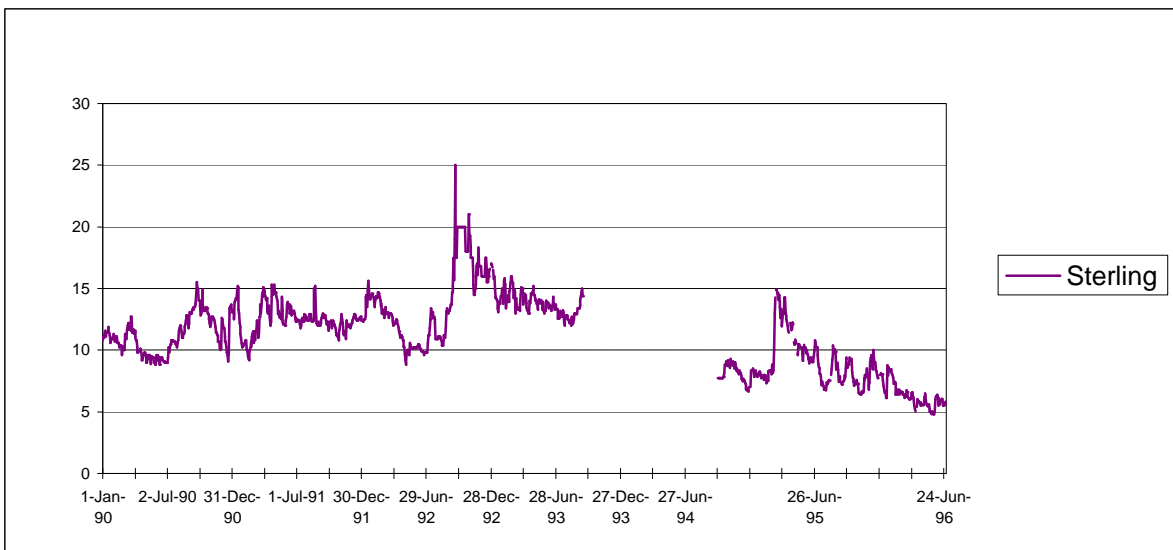
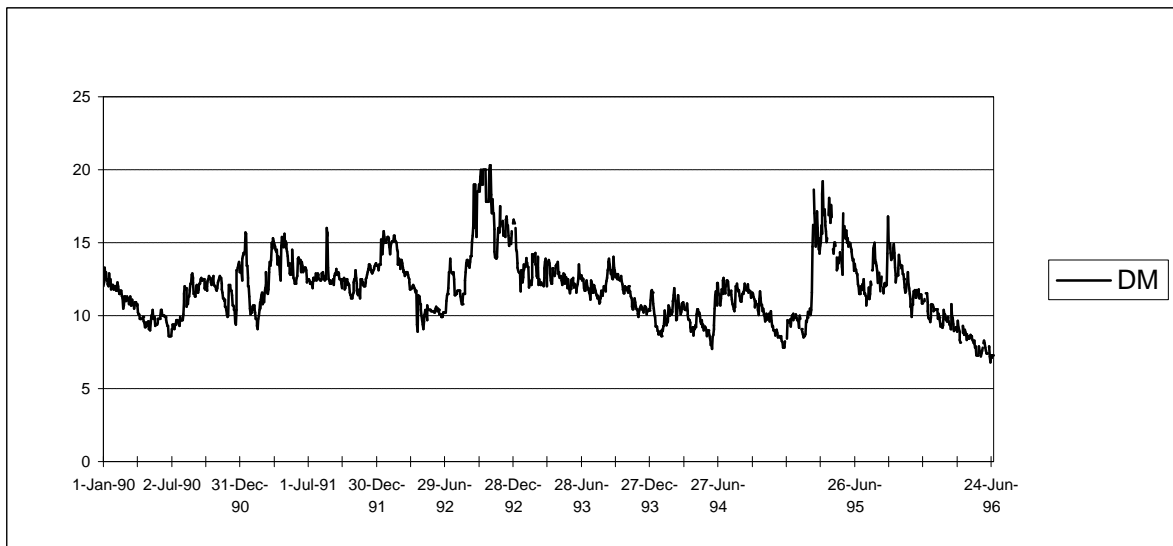
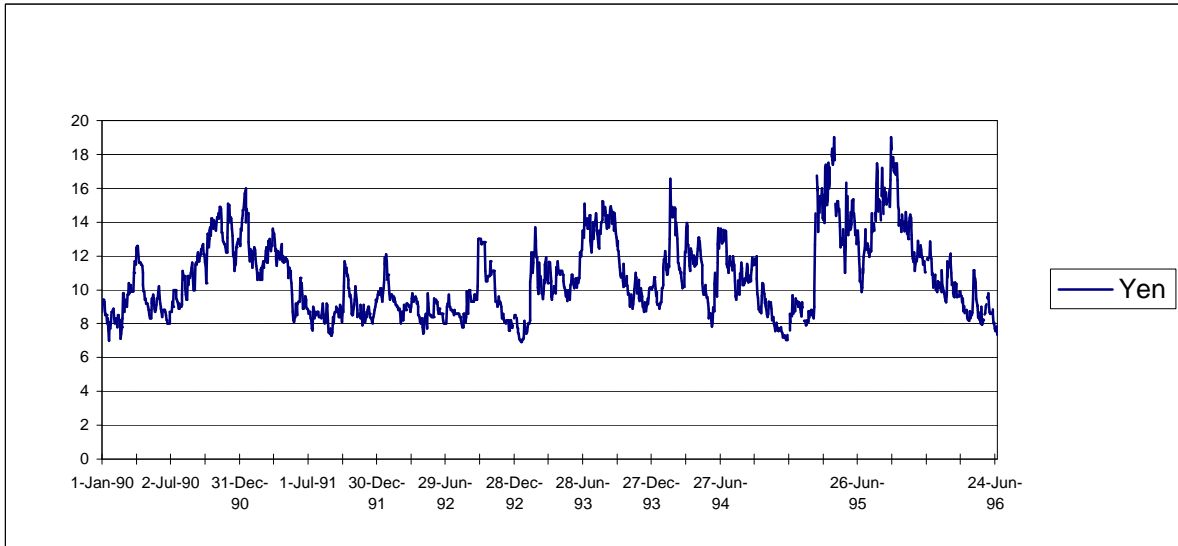
Recent Trends in the DM/US\$ Spot Rate
 Data Source: Federal Reserve Board of Governors



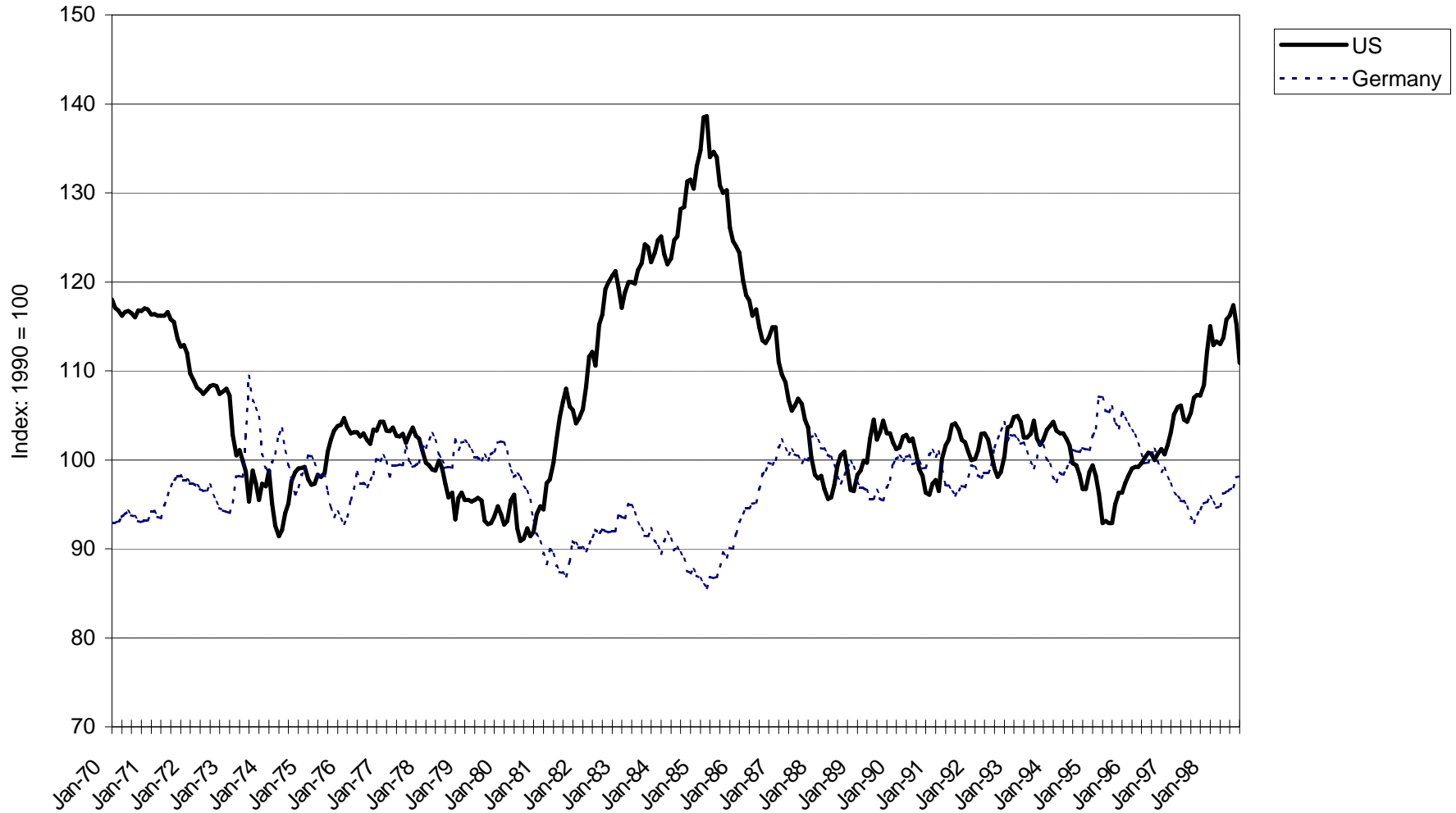
Recent Trends in the Yen/US\$ Spot Rate
 Data Source: Federal Reserve Board of Governors



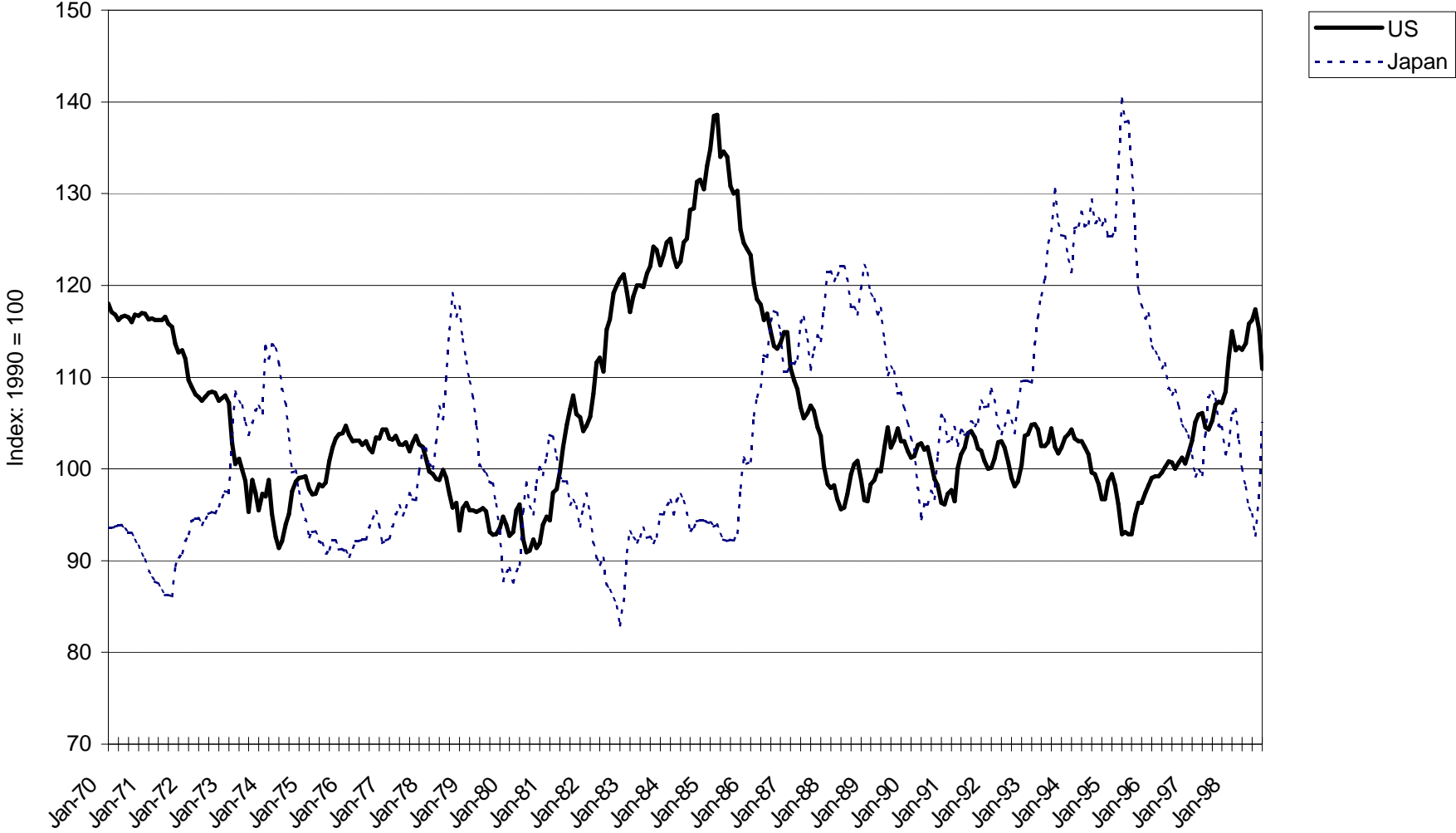
Figure 2.7
Implied Volatility: 1-Month Horizon
Daily Data, January 1990 - June 1996



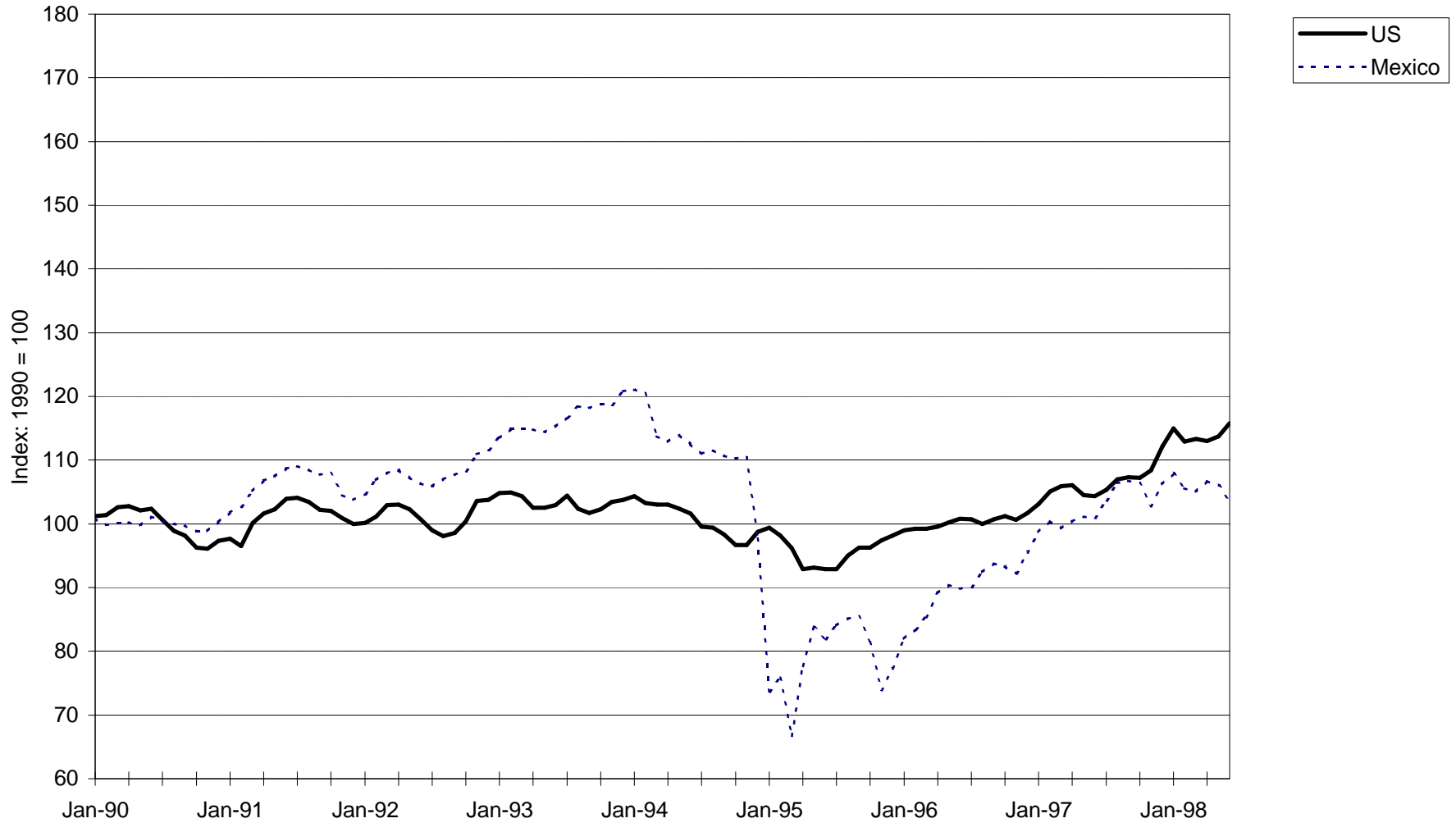
Real Effective Exchange Rates - GERMANY
Monthly Data, Jan 1970 - Oct 1998



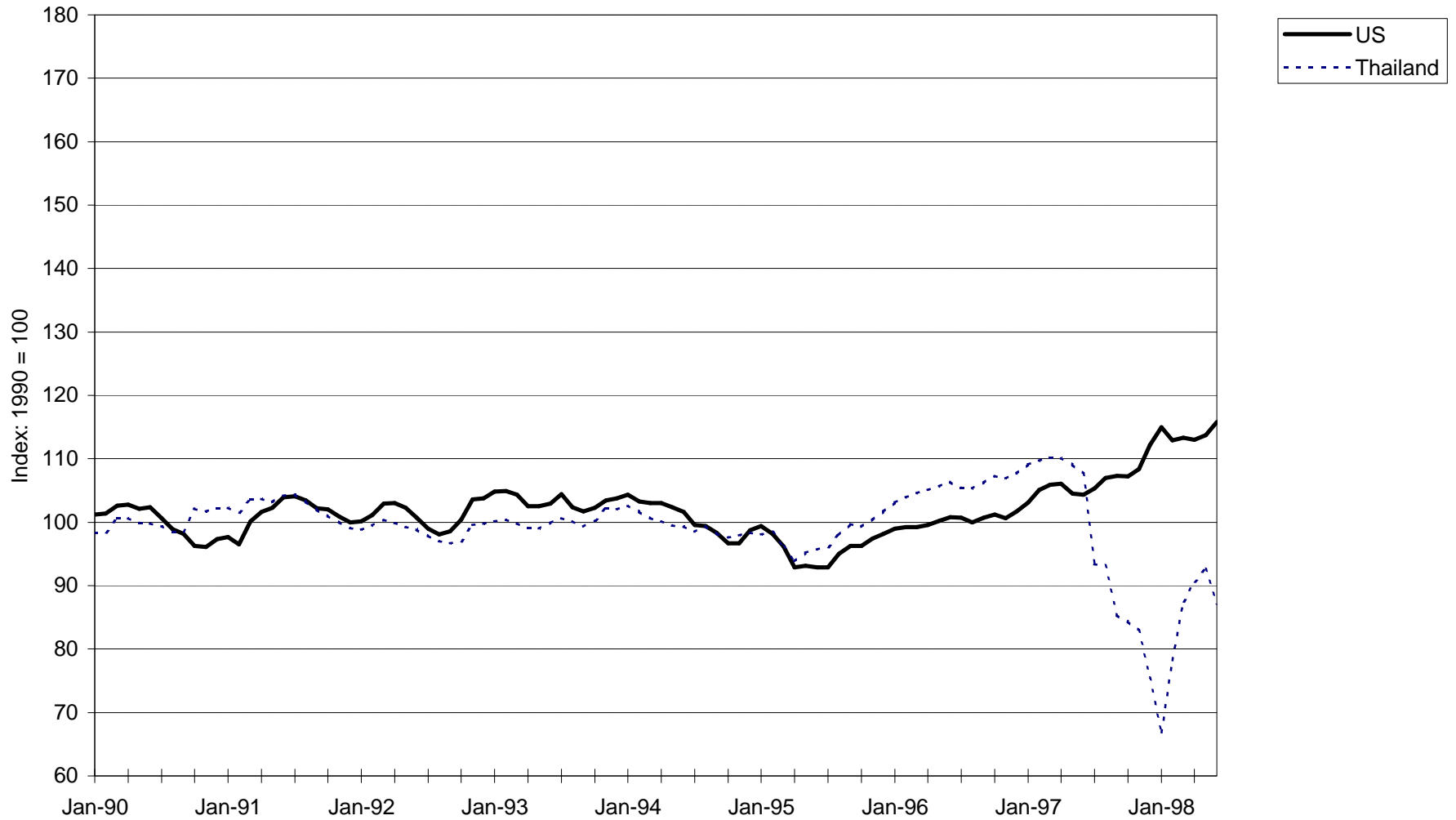
Real Effective Exchange Rates - JAPAN
Monthly Data, Jan 1970 - Oct 1998



Real Effective Exchange Rates - MEXICO
Monthly Data, Jan 1990 - June 1998.



Real Effective Exchange Rates - THAILAND
Monthly Data, Jan 1990 - June 1998.



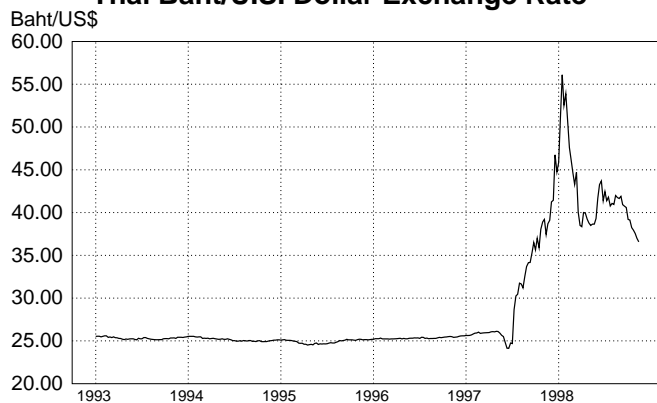
Thai Baht Outlook

The Thai baht's recent rally was ended by the yen's fall this week, as the spot rate weakened past the 37/US\$ level and short term forwards moved right. Meanwhile, interest rates continued to fall as Bangkok banks eased their prime lending rates by 50 basis points to 12.75% this week. The government is currently negotiating its sixth letter of intent with the IMF, with the focus likely to be on fiscal stimulus and banking sector reform. It is likely that an aid tranche will be disbursed in the next few weeks that ought to provide some degree of support for the baht.

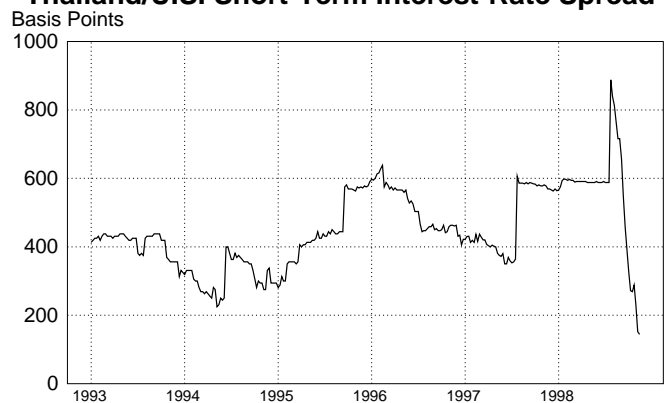
Thailand Key Economic Indicators and Forecasts

	1996	1997f	1998f	1999f
Real GDP Growth (%)	6.7	-1.5	-9.6	6.0
Inflation Rate (%)	5.8	5.6	9.6	-2.0
Curr't Acc't Bal.(% GDP)	-8.0	-1.8	10.1	8.5
Trade Balance (THB bn.)	-416	-175	411.1	355.5
Int'l Reserves (\$ bn.)	38.7	27.0	26.0	28.0
Budget Balance (% GDP)	0.7	-0.9	--	--

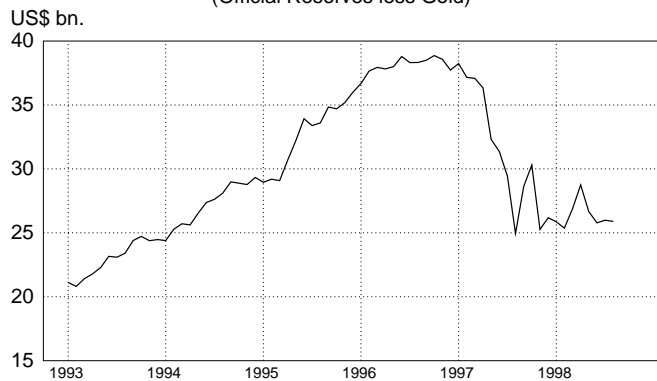
Thai Baht/U.S. Dollar Exchange Rate



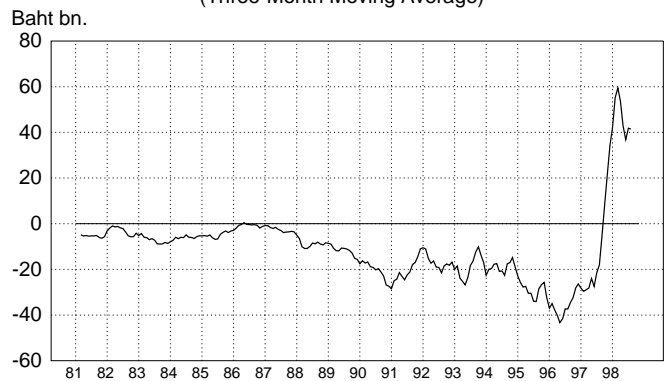
Thailand/U.S. Short-Term Interest-Rate Spread



Thailand's Reserves (Official Reserves less Gold)



Thailand's Trade Balance (Three-Month Moving Average)



Thailand's Stock Market



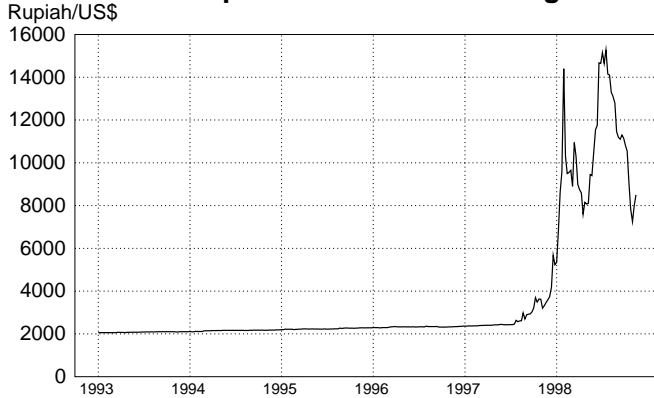
Indonesian Rupiah Outlook

The Indonesian rupiah's sharp rally in October petered out over the last fortnight as concerns that the political temperature could rise in the run-up to the People's Consultative Assembly (MPR) meetings. There have been reports of student demonstrations in various parts of Jakarta this week. The rupiah, however, remained supported by an IMF aid tranche of some \$1 billion disbursed over the last weekend. Meanwhile, interest rates have begun to fall, although they remain high in relation to the region. Three-month SBI rates at 58% appear attractive, but we recommend caution, at least until the MPR meetings are over.

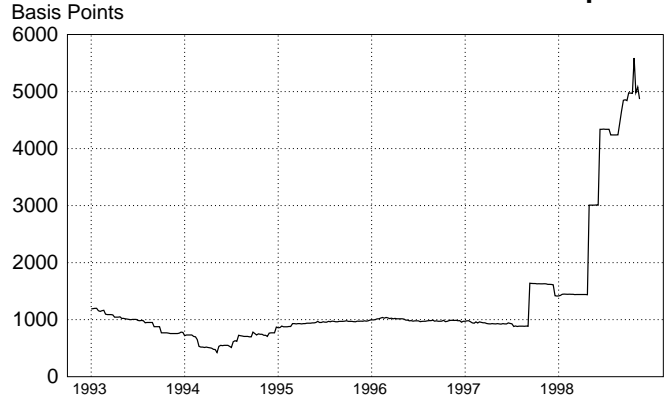
Indonesia Key Economic Indicators and Forecasts

	1996	1997f	1998f	1999f
Real GDP Growth (%)	7.8	4.9	-12.8	0.5
Inflation Rate (%)	7.9	6.6	62.0	20.0
Curr't Acc't Bal. (% GDP)	-3.7	-1.8	4.6	7.4
Trade Balance (\$ bn.)	6.9	12.8	20.9	23.6
Int'l Reserves (\$ bn.)	19.1	17.4	15.0	16.0
Budget Balance (% GDP)	--	--	--	--

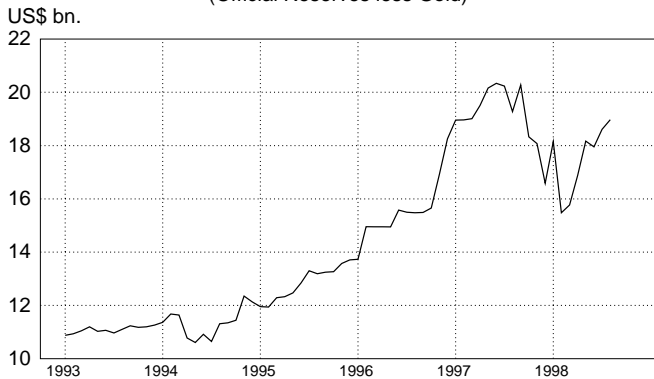
Indonesian Rupiah/U.S. Dollar Exchange Rate



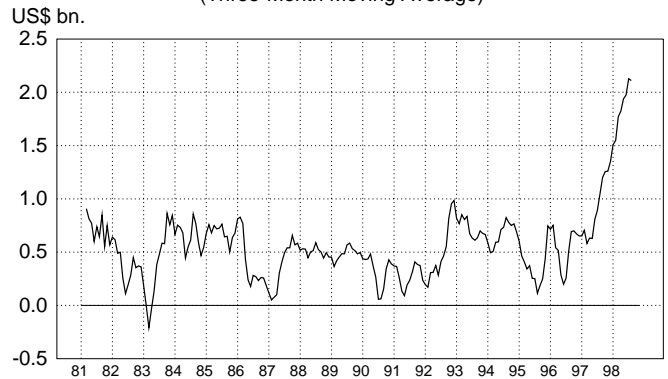
Indonesia/U.S. Short-Term Interest-Rate Spread



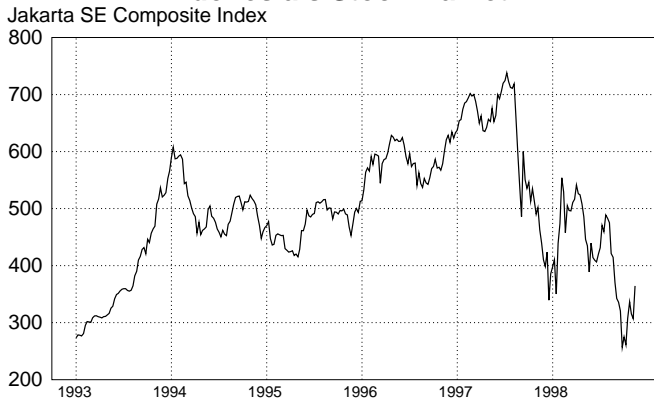
Indonesia's Reserves (Official Reserves less Gold)



Indonesia's Trade Balance (Three-Month Moving Average)



Indonesia's Stock Market



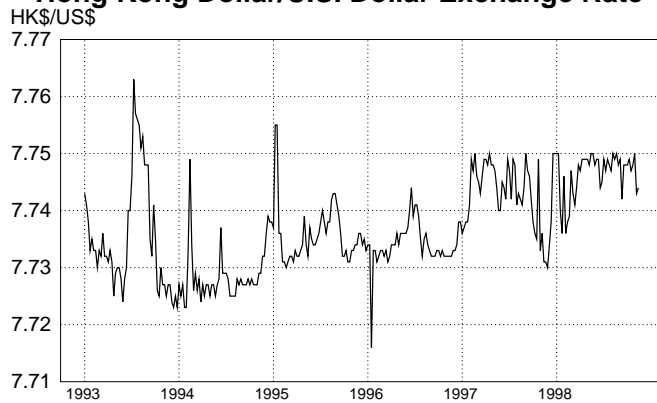
Hong Kong Dollar Outlook

A local press report of November 9 indicated that the government may scrap two of the tough new rules it imposed following its August intervention in financial markets. The government may drop a clause that gives Hong Kong's chief executive the authority to "give direction to the exchanges and clearing houses" and also the new rule that requires investors to disclose large trades on the futures exchange daily. In currency markets, pressures on the Hong Kong dollar peg have alleviated significantly, with spreads over the U.S. dollar at about 1%-2% in recent days. Nonetheless, internal macroeconomic imbalances continue to pose major challenges for policy makers in coming months.

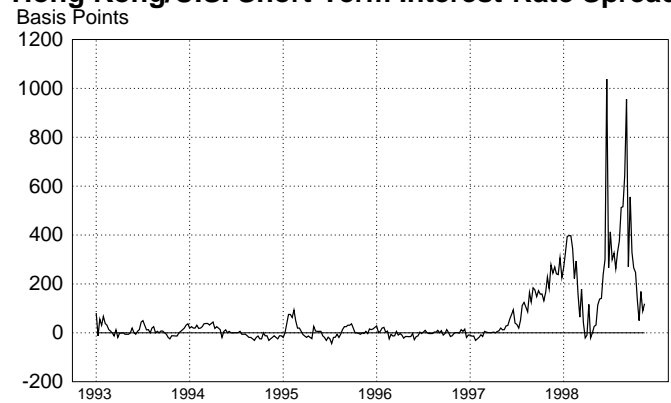
Hong Kong Key Economic Indicators and Forecasts

	1996	1997f	1998f	1999f
Real GDP Growth (%)	4.9	5.5	-3.5	0.5
Inflation Rate (%)	6.0	5.8	3.0	0.0
Current Acc't Bal. (\$ bn.)	--	-2.7	-2.2	-1.5
Trade Balance (HK\$ bn.)	-8.0	-35.0	-53.0	-49.1
Int'l Reserves (\$ bn.)	63.8	90.1	95.0	95.0
Budget Balance (% GDP)	0.25	4.5	0.7	--

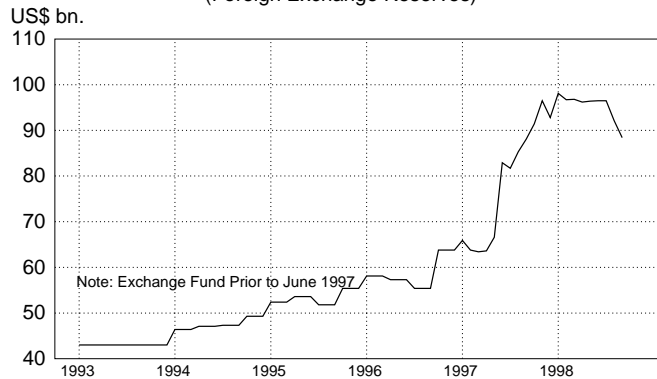
Hong Kong Dollar/U.S. Dollar Exchange Rate



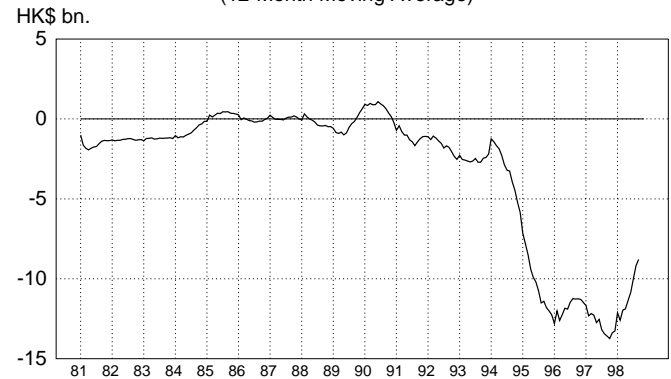
Hong Kong/U.S. Short-Term Interest-Rate Spread



Hong Kong's Reserves (Foreign Exchange Reserves)



Hong Kong's Trade Balance (12-Month Moving Average)



Hong Kong's Stock Market



New Taiwan Dollar Outlook

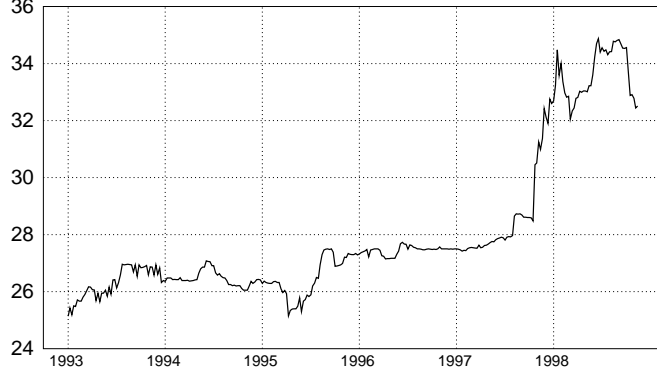
The export momentum has decelerated much faster than anticipated. Exports contracted by close to 9% for the first 10 months of this year; a turnaround does not appear likely in the near term. Since early November, a spate of reports of stock payment defaults and financial troubles at several local firms have dampened market sentiment. The problems prompted swift government response. Several measures to help firms' cash-flow problems were announced, including extending expired loans by six months for operationally healthy firms facing cash-flow difficulty and strengthening new loan approvals. The finance ministry also negotiated the take-over of two troubled bills finance firms by banking consortia.

Taiwan Key Economic Indicators and Forecasts

	1996	1997f	1998f	1999f
Real GDP Growth (%)	5.7	6.6	4.0	4.8
Inflation Rate (%)	3.1	0.9	1.5	2.0
Curr't Acc't Bal. (% GDP)	3.8	3.3	1.3	1.4
Trade Balance (\$ bn.)	13.6	7.6	2.7	1.0
Int'l Reserves (\$ bn.)	88.0	81.5	84.5	86.0
Budget Balance (% GDP)	-8.0	-6.1	-7.4	-7.0

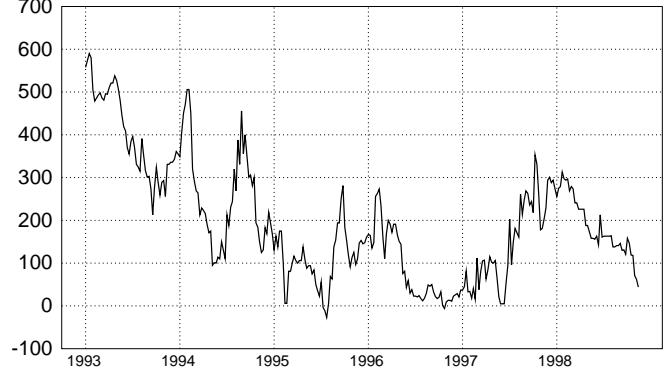
New Taiwan Dollar/U.S. Dollar Exchange Rate

NT\$/US\$



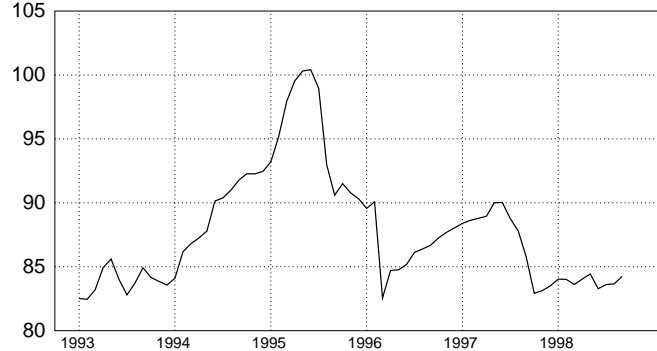
Taiwan/U.S. Short-Term Interest-Rate Spread

Basis Points



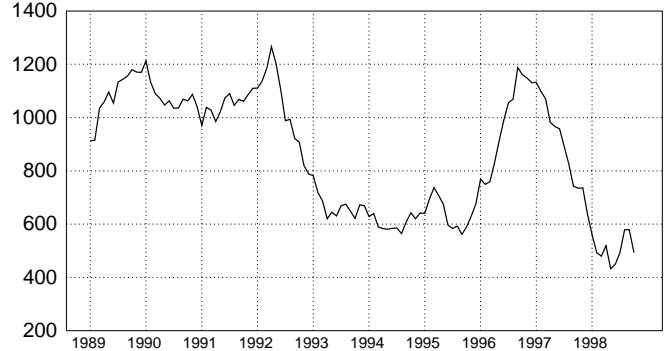
Taiwan's Reserves (Official Reserves less Gold)

US\$ bn.



Taiwan's Trade Balance (12-Month Moving Average)

US\$ bn.



Taiwan's Stock Market

TAIEX Weighted Index



Korean Won Outlook

Usable foreign reserves in Korea reached a record US\$45.27 billion at end-October, surpassing the US\$45 billion target level agreed last month. Its end-July total external debt contracted marginally to US\$152.3 billion, a quarter of which is short-term. The central bank indicated it would continue to pursue monetary easing, insofar as the policy did not conflict with the objective of stabilizing the exchange rate. Overnight call rates, currently at around 7%, are down sharply from a high of 35% earlier this year. Prospects for continued current-account surpluses will help maintain stability in their balance-of-payments position and reserve buildup into 1999. However, a full-fledged macroeconomic rebound is not expected until the second half of 1999.

South Korea Key Economic Indicators and Forecasts

	1996	1997f	1998f	1999f
Real GDP Growth (%)	7.1	5.8	-7.0	2.9
Inflation Rate (%)	4.5	4.6	7.0	4.0
Curr't Acc't Bal. (% GDP)	-4.8	-3.0	11.2	7.7
Trade Balance (\$ bn.)	23.0	-14.2	42.4	32.4
Int'l Reserves (\$ bn.)	33.2	25.0	56.6	82.7
Budget Balance (% GDP)	0.0	0.0	-6.0	-4.0

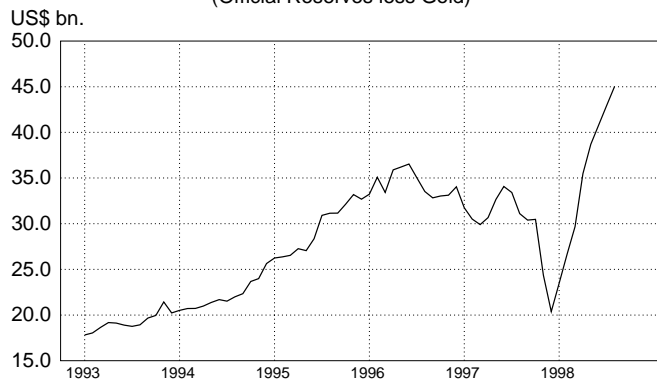
South Korean Won/U.S. Dollar Exchange Rate



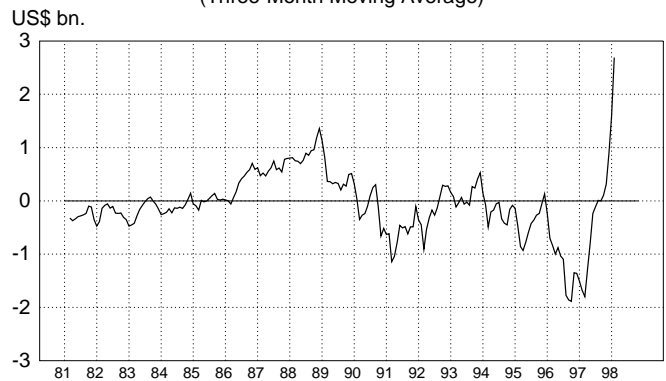
S. Korea/U.S. Short-Term Interest-Rate Spread



South Korea's Reserves (Official Reserves less Gold)



South Korea's Trade Balance (Three-Month Moving Average)



South Korea's Stock Market

