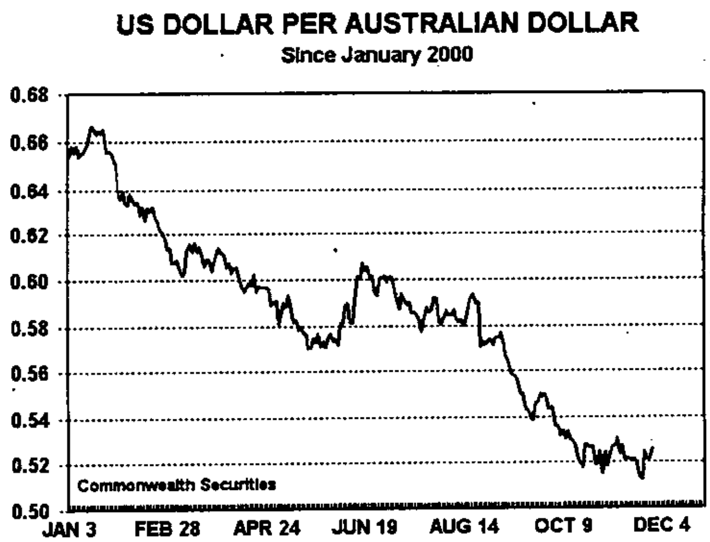
THE FALLING AUSTRALIAN DOLLAR: A Forum

The Australian dollar has fallen steadily against the US dollar throughout 2000. It has also fallen against most other currencies, although not as dramatically. Figure 1 shows the decline of the Australian dollar relative to the US dollar – a steady fall from almost US67 cents in January 2000 to just above US50 cents in late November



The fall has not been anticipated by the financial markets or commentators. What it means - its causes and consequences – remain open areas of debate both within financial markets and in national and international policy debate.

The *Journal of Australian Political Economy* has assembled some interpretations of the dollar from a range of financial market analysts in the hope of promoting debate about the wider significance of the Australian dollar's decline. Each writer was asked to submit an analysis of one to two thousand words.

Forum on the Australian Dollar: The Participants

Those participating in the forum are:

Matt Wade of the *Sydney Morning Herald*, who has been doing much of that newspaper's reporting on how the financial market economists are reading the dollar.

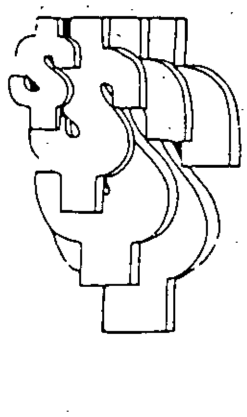
John Edwards, Chief Economist at HSBC, former economic advisor to Prime Minister Paul Keating and author of *Keating: The Inside Story* (Penguin 1996).

Stephen Koukoulas of the *Australian Financial Review* who has been writing extensively on the reasons for the fall of the dollar and its policy implications within Australia.

Peter Williams, freelance media analyst, and Cathy Greenfield , Associate Professor of Communications at RMIT and, with Dick Bryan, holder of an ARC Large Grant researching the financial market media.

Michael Rafferty and **Dick Bryan**, of the University of Western Sydney and Sydney University respectively, who are authors of *The Global Economy in Australia* (Allen & Unwin 1999) and have been researching the global expansion of the Australian dollar.

Frank Stilwell of the University of Sydney.



THE DUD DOLLAR:
How it Confounded the Pundits

Matt Wade

The dollar's slump this year has left currency pundits red-faced and a swag of investors out of pocket. Market economists, politicians and central bankers have been at a loss to explain the magnitude of the decline. Many experts had tipped the Aussie to surge to US70c during 2000, buoyed by strong world growth, improving commodity prices and one-off factors such as the Olympics. So much for the crystal-ball gazers – the dollar slid to an all-time low of US50.70c in November, a fall of almost 25 per cent against the greenback from its January high of US66.80c.

Around Christmas 1999, currency specialists across the world were forecasting that the Aussie would rise. New York investment bank Goldman Sachs went so far as to include the Australian dollar in its top 10 trades for 2000, tipping it to climb to US77c. Most local investment institutions shared this bullish outlook. On December 13 1999, Westpac, a leading player in the local currency market, forecast the dollar to hit US70c in June 2000 and US72c by December. Investors got set for the expected run-up in 2000 and things were looking good in January as the currency climbed from around US63c to almost US67c.

Then, on January 29, 2000, the dollar hit the wall. During thin weekend trading in the New York time zone, it plunged almost US3c in a matter of a few hours after a US hedge fund dumped its holdings. The rout inflicted severe damage on sentiment. Confidence in the dollar evaporated as it was hit by an avalanche of selling.

A host of compelling reasons to sell the dollar suddenly emerged. Initially traders said the expectation of a widening gap between US rates and local interest rates weighed on the dollar. Mixed data early in the year suggested the Australian economy was coming off the boil, while the US economy was showing signs of overheating. It looked like the US Federal Reserve would need to lift interest rates by much more than the Reserve Bank to rein in its runaway economy. Higher rates in the US make local assets relatively less attractive and cut demand for the dollar.

At the same time, the staggering growth of the tech stock-heavy Nasdaq in the US sucked in capital from across the globe, leaving local assets, and the dollar, sidelined.

Some analysts insist that offshore investors see Australia as a "smoke-stack" economy relying heavily on "old economy" commodity exports like coal. This perception, along with the limited number of listed technology manufacturers popular with global investment institutions, also counted against the dollar in 2000.

Officials repeatedly rejected the "old economy" tag and tried hard to talk up the dollar. Reserve Bank (RBA) Governor Ian Macfarlane gave an exclusive interview to London's *Financial Times* on March 15, (something he never does for Australian newspapers) and stressed the range of factors that should have been supportive of the dollar, especially Australia's healthy growth performance. "In this environment" he said, "you would not normally expect to see a falling Australian dollar." The jawboning, clearly aimed at offshore investors, had little effect and the Reserve Bank was forced to buy the dollar in late March to "smooth" its slide toward US60c.

A survey of 127 currencies in April found that since the beginning of 2000 the Aussie had recorded the seventh largest decline in the world against the US dollar. It was being beaten in the depreciation stakes by currency lightweights such as the Libyan dinar and the Romanian leu. The dollar plunged to a two-year low during Peter Costello's budget speech on May 9 as financial markets took a dim view of a surplus apparently pumped up by rubbery asset sales. By mid-May, the dollar had slumped to US56.50c and only just avoided testing the previous all-time low of US55.50c set during the Asian crisis in August 1998. In late May the RBA again intervened to prop up the ailing currency.

The arrival of some weaker economic data from the US in late May, suggesting that the Fed might not have much more work to do on the interest rate front, briefly arrested the dollar's slide. But its failure to rally much beyond the US60c mark appeared to disappoint offshore investors and selling eventually reemerged. Also the long awaited US slowdown proved elusive and the massive global investment funds were caught short of high-yielding US assets. The US dollar again surged in the wake of a fresh splurge on US assets, especially equities, and the Aussie started to 'head south' once again.

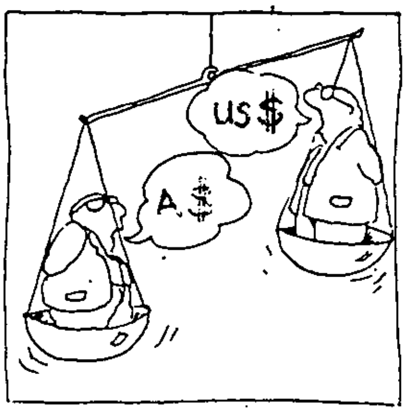
Currency pundits also pointed to the unlikely correlation between the euro and the Australian dollar which was noticeable during the year. Both were testing all-time lows in the wake of the mighty greenback. It seemed, with the Aussie defying traditional fundamentals such as a strong economy and rising commodity prices, the euro had became a trading bellwether for the Aussie. No meaningful economic rationale has been found for this correlation apart from the self-evident assertion that it reflects US dollar strength. While a number of other major currencies, such as the yen and Canadian dollar, have not fallen to the same extent, traders have used the euro as guide for the Australian currency. Volatility on Asian financial markets during 2000 has also effected the local dollar according to some market economists.

In September the Australian currency crashed through its Asian Crisis all-time low and continued to grind down despite the RBA spending more than $500 million during the month in support of the exchange rate. The Prime Minister blamed the strength of the US dollar for the currency woes (a familiar mantra from economic policy makers during the year) and told the nation to "hold its nerve" on the dollar. The Olympic Games, which some analysts predicted would be supportive for the currency, provided no respite at all.

With sentiment toward the Aussie dollar shattered, higher investment returns on offer elsewhere (especially the US) and the emerging prospect of a slowing Australia economy, buyers were scarce and the dollar drifted towards US50c. In early November the RBA again attempted to turn sentiment on the Aussie with what some traders described as the most aggressive intervention since the Asian crisis of 1997-98. While this smoothed the decline, dollar-sellers were always ready to test the RBA's resolve. Some analysts said that at times during November the RBA was the only significant buyer of the local currency. The twists and turns of the US Presidential election caused further gyrations in the dollar as global investors took the view that a Bush victory was positive for the US dollar and a Gore victory could weaken the greenback. In late November the currency was hovering around the US52c mark and in real danger of falling to US49c or lower according to many traders. In late

November there were signs that the US dollar began to weaken against most major currencies and many local pundits said that the Australian dollar's fortunes were about to change.

Yet again the pundits predicted a turning point though few believe it will be back above US60c for some time. Some now argue that the dollar will settle in a new long-term range between US54c-60c.



THE CHEAP AUSTRALIAN DOLLAR*

John Edwards

Despite rising commodity prices, strengthening terms of trade, a narrowing current account deficit, rapidly growing exports, and monetary policy tightening which has matched the US Federal Reserve, the Australian dollar against the US dollar remains well below its quite modest peak in January 2000 and one fifth below its average value since the float of the currency in 1983. Though less marked, the currency has also depreciated against a trade-weighted basket of currencies.

Because the currency responds less to the variables that have determined its value for the last seventeen years, we have been compelled to review the analytic framework of our forecasting procedures. Our re-examination focused on Australia's changing foreign liabilities.

As a result of the re-examination we have now come to the view that the cheap Australian dollar is not accidental, not irrational, and not temporary. It is the long delayed response of markets to the increasing weight and changing composition of Australia's foreign liabilities.

The persistent weakness of the currency raises some big issues for the Australian economy. To the extent it signals that Australian foreign liabilities are growing faster than the market can comfortably absorb, it suggests the central bank and the federal government cannot remain indifferent to the future size of the current account deficit. To the extent the cheap dollar can be sustained, it offers Australia the best opportunity for decades to trade its way towards a markedly lower current account deficit. In this sense the low dollar offers in this new decade the chance to address a vulnerability which has grown over the last twenty years.

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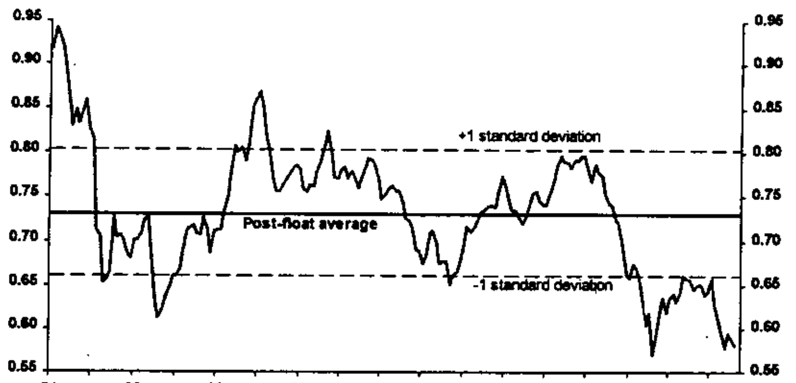
* This is an excerpt from an extensive paper called 'The Cheap Australian Dollar' It is part of an extended collection of three papers by HSBC economists: John Edwards. Anthony Thompson and Grant Fitzner. The Editors of the *Journal of Australian Political Economy* gratefully acknowledge permission to reprint this excerpt. The full version of their paper is available from http://www.hsbc.com.au/htdocs/research.html.

Figure 1: The Australian Dollar Since its Float*



* The Australian dollar was floated 12 December 1983. Monthly average against US$.
Source: Datastream, HSBC

In the last decade, Australia's large and persistent current account has been no obstacle to high output growth, rising incomes and wealth, strong productivity growth, low inflation and financial stability.

Large current account deficits have not impeded growth, but each year the capital inflow required to finance the current account deficit adds to Australia's foreign liabilities. The rapid increase in these liabilities over the past two decades has fundamentally changed the market for the Australian dollar - in three powerful ways.

The first is simply through the accumulating weight of Australian foreign liabilities, which have trebled over the last twelve years. Despite increasing global diversification of asset portfolios, the increasing stock of Australian liabilities held offshore ultimately dulls the foreign appetite for additional Australian liabilities. A possible result is a cheaper currency.

The second is through a change in the composition of Australian foreign liabilities towards foreign purchases of shares in Australian companies, and increased foreign borrowing by Australian banks. Both these liabilities are more volatile and market sensitive than the government borrowing, direct equity investment and long term corporate borrowing they have replaced.

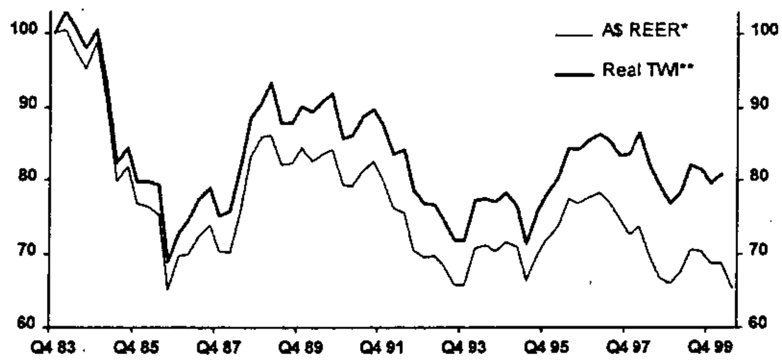
The third is through the transfer of some portion of the foreign exchange risk of Australian foreign liabilities from the onshore recipient to an offshore provider, a shift driven by the increasing importance of portfolio equities and hedged bank borrowing in foreign currencies.

The increasing weight, changing structure and shifting foreign exchange risk have all enhanced the influence of foreign liabilities in determining the foreign exchange value of the currency. The role of growing foreign liabilities would have been more evident much earlier, however, had not all three earlier periods of accelerated growth in liabilities in the years since the 1983 float of the currency not been accompanied by a much more severe tightening of monetary policy than has accompanied the recent expansion of the current account deficit. For the first time since the float, the impact of an acceleration in the growth of foreign liabilities has not been offset (or disguised) by sharply higher short term interest rates.

A substantial premium of Australian long term interest rates to US rates may have offered support to the Australian currency, but for one reason or another long term interest rates have not played a big role in driving demand for Australian dollar assets. While the weight of foreign liabilities has increased, Australian interest rates at the long end have converged on global rates. This has likely left more of the relative value in Australian dollar denominated assets held offshore to a view that the currency is cheap – that is, that it will appreciate.

The result of this conjunction of forces is a big and likely long term step-down in the average value of the Australian dollar as the weight and market sensitivity of foreign liabilities has increased. In size and significance the step down in the value of the currency may well resemble the step down of 1985 and 1986 in duration and consequence.

Figure 2: Real Exchange Rates: A Step Down



* A$ real effective exchange rate
** A$ real trade weighted index
Source: OECD, Reserve Bank of Australia

While falling in average value, we would also expect to see increased sensitivity of the exchange rate to changing perceptions about the value of Australian dollar assets (especially in the equities market), and decreased sensitivity to small expected differences in short term interest rates and to commodity prices – two traditional value drivers of the currency.

Implications of Changing Australian Liabilities

The increasing weight of Australian foreign liabilities, their increased market sensitivity and the transfer of substantial Australian dollar risk offshore have combined to exert pressure for both a cheaper Australian dollar, and one more sensitive to capital flows than to commodity prices or views about the trade balance.

The result is a lower exchange rate, which may persist for some years to come. Depending on how the Australian economy responds, this may be an excellent thing. It offers Australia an opportunity to build towards a trade surplus by making exports more profitable, and imports more expensive. A trade surplus will reduce the current account deficit, just as the trade deficit has been responsible for increasing it in recent years. Since 1997, a trade *deficit* equivalent to around 2% of GDP has taken the current account deficit from around 4% of GDP to a little under 6%. A trade *surplus* of 1% of GDP would halve the current account deficit to between 2% or 3% of GDP, which would mean Australia's foreign liabilities grew by a little under that rate.

Moving to a trade surplus, however, means that domestic demand must for a time grow less rapidly than gross domestic product, and savings must grow more rapidly than investment. The policy prescription for this outcome is substantial underlying government budget surpluses, and somewhat higher real interest rates.

In all probability the demand for investment will be just as big in the coming decade as in the decade just past. This is because investment requirements will remain high as Australia continues to adopt a stream of new technologies. But a smaller current account deficit may actually be a precondition for sustained investment, because a persistently big current account deficit will sooner or later create the circumstances in which Australia is compelled to return to a current account surplus – just as the deficit economies of Asia were compelled to build surpluses after 1997.

A current account deficit of 2.5% of GDP would be consistent with gross domestic investment of around 18% of GDP, so long as gross national saving could be maintained a little above 15% - a little below its average rate over the previous decade. A government contribution of around 2% of GDP would go a long way to assuring Australia was able to make the necessary national savings.

New Analytic Framework

If the story we tell about the currency is right, we need to pay less attention to commodity prices and the trade account and more attention to changes in the relative attractiveness of Australian assets. If offshore interest in Australian equities declines because other markets move faster or certain classes of stocks are in favour, for example, we would expect the Australian dollar to decline. This is likely part of the story of what happened to the currency in the last quarter or last year and the first quarter of this year, as offshore interest in Australian resource stocks rose and then declined, while global attention turned to technology, media and telecommunications stocks and to rebounding Asian equity markets.

We are unlikely to see a sustained appreciation of the Australian currency unless and until:

- Australian equities are expected to perform better than other regional equities, either because of rising Australian profitability or because the Australian dollar is expected to appreciate, or
- the central bank substantially raises interest rates while those elsewhere remain steady, or
- other global assets, such as US shares, are perceived to be poor value, or
- the Australian dollar is perceived to be so cheap that foreign direct investment increases rapidly through takeovers (either because the Australian entity controls offshore assets not correctly valued, or because the Australian dollar is expected to appreciate), or
- an emerging trade surplus is so strong and apparently persistent that Australian net external liabilities begin to fall compared to the size of the economy, or
- the US dollar weakens generally against other currencies

Changing our Forecasts

Our new forecasts for the currency are based on our premise that the current low value of the currency is not irrational and not temporary. Though the trading range may well be quite wide, we doubt the currency will be able to rise above 58 US cents by the end of 2000. Far from seeing a runaway appreciation towards and beyond 80 US cents which were characteristic of previous upswings, we doubt the currency can move much beyond 62 US cents over the next few years, due to the impact of the Australia's foreign liabilities.

How it Affects the Central Bank

If we accept that the increasing weight and changed structure of Australian foreign liabilities is the reason the Australian dollar has not appreciated in response to small interest rate changes and rising commodity prices, we also accept that its current value is not accidental, not the result of overshooting, and not temporary. The current value of the Australian dollar is arguably more nearly related to its fundamentals than at any other time, because the market is not distorted by either exceedingly (and temporarily) tight monetary policy, or by large scale hedge fund speculation. The trading range is unlikely to be temporary, because the weight of foreign liabilities will continue to grow with Australia's current account deficit. We also expect bank debt and offshore share holdings to continue to expand as a share of total foreign liabilities.

A long term low currency has two implications for economic policy. The first is that the small monetary policy moves appropriate for the domestic economy will not have very much impact. The second is that so long as Australia can maintain low inflation, its competitive position will remain extremely strong and there is every reason to expect the trade account to return to a strong and growing surplus within a few years. In this sense the cheap Australian dollar is a good thing and offers Australia the first clear opportunity for two decades to work its way towards a persistent trade surplus, and ultimately toward a much narrower current account deficit.

BEHIND THE RECORD LOW FOR THE AUSTRALIAN DOLLAR

Stephen Koukoulas

The Australian dollar has recorded a series of record lows during 2000. In a climate of strong domestic and global economic growth, a narrowing current account deficit, rising terms of trade and broad policy credibility, the $A depreciation has confounded most market analysts, the government and the custodian of the exchange rate, the Reserve Bank of Australia.

In looking for reasons behind the unexpected depreciation, the usual suspects appear not be at fault. Past bouts of severe $A weakness have coincided with one or more of the following: falling commodity prices, falling terms of trade, severe economic weakness or recession, a deterioration in the external accounts, in particular foreign debt, or policy shortcomings or ineptitude from either the government or the RBA.

At face value, with commodity prices and the terms of trade having risen during 2000, with the domestic economy recording strong growth rates, with the current account deficit narrowing and the government returning the budget to surplus, something else must account for the $A fall.

Before delving into those factors, it is useful to emphasise some background on how the value of $A changes. Importantly, with a floating exchange rate and with very few capital controls in place to dampen capital flows, the interaction of market forces will determine the level of the $A. If, for whatever reason, the market judges that the value of the $A should move, or so-called 'real money flows' push it higher or lower, the freely floating exchange rate will adjust. Throughout 2000, that adjustment has generally been lower.

Another key point is that, by definition, the $A exchange rate is a relative concept. That is, the $A is quoted against other currencies, often the $US, or it is measured on a trade weighted basis. This means that when judging the fundamentals of the Australian economy and influences on the level of the $A, it must be done relative to the fundamentals of other countries.These issues will be in the background as the factors behind the $A depreciation in 2000 are explored.

The definitional aspect of the $A decline is that it represents an outflow of capital from Australia. With Australia's current account deficit around $8 billion per quarter, net inflows of this amount are needed simply to keep the exchange rate constant. If capital flows fall short of that amount, the $A will decline. If there is disinvestment, the fall will be sharp.

The RBA Governor, Ian Macfarlane, and others, have dismissed the notion that the current account is to blame fo the $A decline, suggesting that if it was the cause for the $A decline, why did the $A rise during 1999 when the current account balance was deteriorating?

In answering this, significant capital inflows must have been supporting the $A in earlier episodes, including in 1999. An examination of financial market views during 1999 reveal near universal optimism that a strong world economy and with it, strong commodity prices would see the $A rise. The scramble of the investment funds to 'buy Australia' saw the $A rise.

In addition to an upbeat commodity price scenario as a reason to buy the $A, there was also a feeling that Australia was one of the fastest growing economies in the world; it was one of few countries where the fiscal policy settings of the government had Budget surpluses and public debt elimination as key priorities. There were also many policy issues being debated, most notably tax reform, which kept the Australian economy in the investor spotlight.

During 2000, the rest of the world grew to the point where Australia's growth was no longer outstanding. The fiscal position of many other countries improved to the extent that Budget surpluses were common - in Australia, the surpluses were being squandered. During 2000, when the new tax system came into being, the economic policy agenda had nothing, absolutely nothing, on it.

In early 2000, the boom in technology stocks raised the level of the debate about the technological transformation of the world economy. A perception developed that Australia's low information technology base in publicly listed corporations, certainly relative to other countries, was a reason for investors to look elsewhere. The $A was accordingly marked down.

In terms of the perception of policy shortcomings from the government, the erosion of the Budget surplus through large income tax cuts, increases in social welfare (these were both linked to the introduction of the goods and services tax), extra spending on rural and regional Australia, extra spending on defence (including in East Timor), the dropping of the proposed Timor Tax which would have raised closed to $1 billion, saw the Budget surpluses undermined just as they should have been increasing.

In terms of the economic policy vision of the government, the cupboard was and is bare. Talk of privatisation of the remaining part of Telstra held by the government will only happen after the election. Talk of reform of superannuation is for sometime in the future. Talk of other economic policy issues is light. This keeps the focus away from Australia. While the `policy failure' issue is not one of the government doing the wrong thing, it is a case of the government doing nothing.

The $A was further undermined by a strong $US. Not that a strong $US alone explains the fall, given the $A against the yen, the trade weighted index, several Asian currencies were also at record lows and the $A fell sharply against the pound and euro.

The focus on US financial assets as a destination for funds from international investors and the undeniably strong $US also kept downward pressure on the $A. A sound argument has been made that foreign inflows into the US stock and bond markets, as investors look for high returns on the one hand, and perceived relative safety in bonds, on the other, inflated the $US, US assets reinforcing the downward momentum for the $A.

The issue is brought home by the fact that national savings levels in Australia have barely moved over the past five years, while net foreign liabilities, including foreign debt have continued to rise and the current account deficit has averaged 4.5 per cent of GDP.

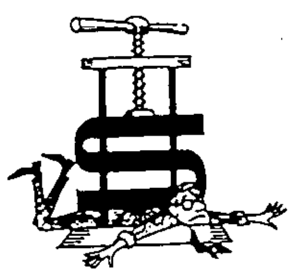
As the $A fell to record lows of US55c, prompting RBA intervention to support the $A, attention turned to the level of the RBA foreign exchange reserves. Reserves had halved between mid 1997 and mid 2000. Here was a situation where the $A was falling rapidly, and the RBA was intervening with a small stockpile of reserves.

Speculation began to build that the RBA might run out of reserves. If there was a hedge fund attack on the $A, the fall could be severe with the RBA powerless. The threat of such a move appeared to keep potential buyers of the $A away from the market for fear of being burnt - again.

During 2000, Australia simply fell off the international investor radar screens. In a climate of free and open capital markets and global investors keen to eke out the highest and safest returns, Australia lacked a feature, be it policy driven or fundamentally based, that saw sufficient capital flows to support the $A.

The earlier beacons to support capital inflows to Australia, and with it the $A, were no longer there. There was no economic policy vision, the issue of privatisation was too hard, given the difficulties in the Senate, while spending on training and education or views on how Australia might best embrace the technological revolution were notably absent. It was a potent cocktail that saw the $A fall to levels never before seen.

It even prompted the RBA to lift interest rates, risking a severe slowing in the Australian economy into 2001. The absence of capital inflows and the reduction in living standards that the low $A inevitably brings could lower the longer run growth potential of the Australian economy. It requires policy vision, a reinvigoration of debate about economic reform and an agenda on positioning Australia to take maximum advantage of the technological revolution.



MEDIA RHETORIC ON THE DOLLAR: The Battles of "Our Dollar"

Cathy Greenfield & Peter Williams*

It is not news that the value of the Australian dollar has fallen to unprecedented levels. Or rather, it is news. It has been news throughout 2000, not only in the Business pages of the press and business/finance segments of radio and television news and current affairs, but also repeatedly in the front pages, editorials and lead items. Is this simply a commonsense correlation of media coverage with the empirical facts of the real economic world? Or is there something else to be noticed and taken into account when we attempt to make sense of the phenomenon of the falling dollar?

Others have noted features that contribute to the view that there is a point in considering the media coverage of economic events. These include: the relative upsurge and changes in economic reporting which occurred from the 1980s (Schultz, 1993; Toohey, 1994; Tunstall, 1996:354-372); stylistic features of economic news reporting (Goddard, 1998); audience comprehension of TV economic news (Goddard *et al*, 1998); the link between economic commentators in the media and opinion-formation (Gittens, 1995) and in particular between these commentators, neo-liberal governments and their electorates (Hindess, 1997:86). With these authors, we argue that both the amount of media attention devoted to financial events and the forms this attention takes deserves some analytical attention of its own, because of its role in the particular kinds of economic activity that come to define the 'real economic world'.

An Official Account

The Reserve Bank's orthodox economic account of the currency fall, in its November *Statement on Monetary Policy*, incorporates an

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* This research was funded by Australian Research Council Large Grant A10009141.

unproblematic – or face-value – view of the role of 'economic news'. The Statement deals with the putative intentions or motivations of market actors and is concerned with a sharply delimited set of outcomes. It tells readers that the current fall of the dollar is exceptional in the short history of its flotation, not because it is a fall but because it was unexpected, unaccompanied as it has been by any "significant negative external shock" (RBA, 2000:15). Hence the level of conjecture about its causes. Identifying these is a difficult job: "the influences on the demand for currencies are ill-defined and variable" (p. 16). Nevertheless, patterns are detected – falling into two clear periods (January to July 2000, and "the period since August") – and the following factors noted. For the first period, the determining factor is economic news and its interpretation as "changing the growth outlook for Australia and the US", and thus "actual and expected interest rate differentials" (p. 16). In the second period, with only three large daily falls but a "series of small but persistent daily falls" (p. 17), the Statement refers to the range of explanations which market dealers and commentators have offered – "chartist behaviour and market dynamics such as trend-following or momentum trading" (p. 18), and the Australian dollar's close and newly emerged relationship with the euro – and to the declining importance of interest rates as a factor.

Given governing Treasury and Reserve Bank policy frameworks, this account is entirely unsurprising. In its identification of determining factors it demonstrates a familiar monetarist prioritisation of the relation between the value of the currency, inflation and interest rates, and a general overlooking of the much wider connections which arguably guide 'market perceptions' and 'sentiment'. Much, though not all, media coverage of the fall of the dollar adopts similar prioritisations: for example, while reference is made to the US Presidential elections putting US Federal Reserve decisions on interest rates on hold, the overall significance of the political trade cycle is neglected. Certainly it is extremely rare to find any registration of the role of financial journalism itself in engendering the 'sentiment', presenting the 'economic news', or guiding the 'interpretation' of that news which the Reserve Bank identifies as a determining factor in runs on the dollar.

Media Rhetoric

If attention were to be given to a serendipitously assembled dossier of clippings[1] on the fall of the dollar in the 'second period' noted by the RBA and to concurrent monitoring of electronic media, the following features could be noted:

- A recurring 'baffle factor': readers are presented with a Reserve Bank chief who "frankly admits that he does not understand why the Australian dollar is so weak" (Colebatch, 2000b); with a parade of experts who are "lost for words" (Maiden, 2000) telling them "we are in uncharted territory" (Chessell, 2000); and with scorecards of experts' misreading of the dollar – "analysts' Australian dollar forecasts have been left in tatters" (Papuc, 2000d), "Dollar prophets all at sea" (Papuc, 2000).
- A new economy factor, or "the tech effect" (Maiden, 2000b).[2] This factor figures in different ways: through reporting of Macfarlane's rejection of the new economy explanation (Colebatch, 2000b), and reporting of Costello's contesting the *perception* of Australia as an "old-style economy" (Hudson, 2000; Gordon, 2000a); and in numerous correspondents' explanations of the dollar's fall (Colebatch, 2000a; Gordon, 2000; Papuc 2000c).
- A metaphor of war: explicit in headlines – "World War on currencies", "All quiet on the $A front, but for how long?" and "G7 sends in big guns to save currencies" (Hale, 2000a, Hale, 2000; Atkins, 2000); recognizable as a narrative device – "market and traders would take rest before mounting any fresh assault on the currency" (Papuc, 2000b); and in Howard's Churchillian exhortation to Australians to "hold your nerve" (Marris, 2000).

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1 The clippings to hand were from *The Age*, mainly, and *The Australian*, and we considered the month of September. Of 39 stories, 6 were front-page or near front-page stories, one was an Editorial; the remainder were from the Business section of the two papers. Stories about the fall of the dollar relating specifically to individual companies were not included.

2 This was particularly evident in September coverage, because of the pronouncements of high-profile delegates to the WEF on the virtues of the 'new economy'.

- A diagnosis of a crisis state: explicit in the *Weekend Australian*'s "Currency Crisis" header (9-10 September:4) and *The Age*'s Editorial subheading (Friday 22 September:10); implicit in other descriptions – "It was an extraordinary day for the Australian economy" (Hudson, 2000), "Fears of an inflation blow out..." (Gordon and Maiden, 2000), "Another night of fear for $A" (Wade and Chessell, 2000).
- The dollar as *dramatis persona*, an Aussie battler: "it's not the Australian dollar's fault", and the dollar is "still searching for large institutional support" (Dabkowski and Tomazin, 2000); the dollar "slumped", "languished", "crashed" (No by-line, 2000; Papuc,2000a; Wade and Wroe, 2000).
- A less 'baffled', generally less dramatised – more savvy – set of accounts in the longer, 'Comment' and 'Analysis' columns: Gittins' pinpointing of "The real story" of a world economy "financial bubble" (Gittins, 2000); Myer's identification of sectoral differences and export opportunities resulting from the currency's decline (Myer, 2000); Hughes' diagnosis of "a productivity dynamism" linked to a more competitive "new economy" as the only way to lift the dollar, and his rejection of RBA tactics – "Interest rate defences of the currency are still mug's games" (Hughes, 2000); Maiden's cautious identification of the "liquidity effect" – resulting from the decline of the "so-called macro hedge funds" – as joining with the "tech effect" and the "commodity price effect" in "bearing down on the currency" (Maiden, 2000b).
- The structure of the daily 'Money' column in *The Age* Business pages: a headline which incorporates a relation between the dollar and interest rates, the RBA, or some other finance factor; an opening paragraph presenting an event (an exchange rate rise or fall), followed by a paragraph placing this event in a wider currency or finance market context; a paragraph providing an expert's explanation of the event, in direct quotation; a closing paragraph citing the bond rate; a graph charting the hourly movements of the dollar for that day.
- Particular forms of address: in the Business pages the reader is addressed as a discerning investor; on the front pages, the reader is addressed more broadly as the anxious citizen, alert to political-

> economic factors, so that, when the dollar hits the front page on September 15, the story is framed in terms of the Federal Opposition's view of the currency slide as "a reflection of the government's reliance on consumption to drive the economy rather than investment" (Hudson, 2000a).

Of what significance are these details of theme and presentation? The theme indicated by the 'baffle factor' ensures that what repeatedly confronts audiences is a narrative played out in part as a mystery story, replete with on-going suspense and shadowy actors. The long-term effect is a contribution to a particular understanding of 'the economy' as something that is know-able – having its own internal logic and nature – and yet unknown: already understood, yet in need of explanation. The 'new economy' theme helps the narrative of the dollar connect to, and in fact contribute to, a realignment of our whole way of understanding the nation, its future and where its interests are to be found. The metaphor of war, the diagnosis of crisis, the dollar as a dramatic actor, are simply the most obvious means by which the "significant statistical change[s]" which constitute most economic news (Goddard *et al*, 1998:13) are dramatised, and assisted into an attention-grabbing role in public life.

The different genre of 'Comment' pieces indicates both the variation in finance journalism – it is not all of a piece – but also the general limits of any deviation from the official account of the RBA and mainstream neo-classical and monetarist frameworks of economic interpretation. The formula of the Money column encapsulates both the routinisation of the hourly scrutiny of the currency and the ways in which finance journalism produces its "facticity" effect (Goddard, 1998:77), particularly important to reporting in persuasive and memorable form the abstract events of the finance world. The particular shape this facticity takes, and its established place in the Business pages where the point of view offered to the reader is that of an actual or potential investor, ensures the abstraction of the information from other factors: "externals" (RBA, 2000:*passim*). While the reader-as-investor/shareholder is by no means absent from other segments of the print media and from television, radio and internet content, the hermetic concerns and accompanying mode of address characteristic of finance and business reporting is thrown into relief by the front page mode of address to the reader-as-citizen.

Conclusion

With the floating of the dollar in 1983, financial journalism and wider economic commentary found a new and endless subject of speculation, in all senses of that term. As well as a specifically anti-Labor concern with the Hawke government's economic policy, speculation about the fortunes of the dollar proliferated to become a wider social preoccupation.[3] What constituted an inculcation of a very elementary form of economic literacy via various forms of media hardly ever came to terms with the complexity of the current account deficit, that is, the importance of the value of the dollar for imports and exports. Concern over the dollar was cast in terms of 'the national interest', and 'the Australian way' and thereby overlooked the different sectoral interests of, on the one hand, mining and agricultural exporters and, on the other hand, value-added manufacturing, telecommunication and transport which needed to import increasingly locally unavailable technology. Once set, this preoccupation with the value of the dollar operated as a measure of national prosperity and, more pathologically, national identity. Seventeen years later, Case, writing in *Personal Investor*, indexes this now established commonsense: "When the dollar dives most of us suspect that *our* economy is going down with it. There is a sense that the rest of the world dislikes *us* or has simply forgotten about *us* altogether" (2000:80, emphasis added).

For us, what is notable about this literacy is that it is the literacy and numeracy of finance, commerce and business, massively reinforced by the current Federal Government's education policies. It avoids the complexities of cultural and economic histories, let alone the social effects of a raft of current Government and organizational policies, amongst them the defunding of Medicare, the privatization of Telstra, the abandonment of the social infrastructure of banks and social security outlets, the privatization of schooling. While some are drawing attention to the impact on markets of (amongst other things) a "hyperactive media" (Shiller, quoted in Maiden, 2000a) we are not arguing that media

3 The 40% depreciation of the dollar in 1985-86 was an earlier highpoint of this preoccupation, as *Australian* journalist Paul Kelly notes in his rambling history of the period (Kelly, 1992: 196).

reporting of currencies necessarily affects the rate. However, the explanations involved in such reporting and commentary do serve to legitimate particular kinds of economic and social policy. News and current affairs, with the rise and rise of financial journalism,[4] have become increasingly less analytical of the connections between political and economic practices. The prioritisation of the finance sector, and its priorities, enables the relegation of other factors (eg, labour issues or environmental concerns) which might take policies in other directions. This prioritisation is not simply a fact of globalization which the media then report on: media arrangements and journalistic practices enable and consolidate this process. They provide material cultural conditions for the connections between politics and economics.

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THE AUSTRALIAN DOLLAR'S ROLE AS A GLOBAL CURRENCY

Michael Rafferty and Dick Bryan*

At a 1999 Reserve Bank conference on exchange rates, US economic commentator and portfolio investment analyst, Woody Brock, observed that economics is having such difficulties explaining the behaviour of international capital flows and particularly exchange rates that almost anything said about them is being taken seriously (Brock 1999). The range and variable quality of the explanations offered for the recent depreciation of the Australian dollar demonstrates this in spades. The explanations have ranged across many issues, including the lack of so-called new economy activities in Australia and the perennial current account deficit/foreign debt problem.

The steady decline of the Australian dollar has demonstrated that any reference to 'the fundamentals' as a determinant of the exchange rate is found wanting. In formal economic theory, 'the fundamentals' refers to a purchasing power parity conception of exchange rates. Indeed, the *Economist* magazine 'Big Mac index' - used as a tongue-in-cheek measure of actual exchange rates against purchasing power parity ('the fundamentals') - showed the Australian dollar even at the beginning of 2000 to be 38% undervalued (*The Economist*, 2000). Consistent with such evidence, Reserve Bank projections actually expected the dollar to rise in value over 2000 (Macfarlane 2000: 1)

There is ample space in the conventional wisdom for actual exchange rates to deviate from 'the fundamentals' for relatively short periods, but eventually the gravitational pull of the fundamentals is supposed to exert itself. The steady and apparently relentless decline in the Australian dollar illustrates deep problems in the formalism of exchange rate theory. Accordingly, the policy makers who have historically embraced that formalism are at a loss. Even the Governor of the Reserve Bank, Ian Macfarlane, whose mandate includes intervening in foreign exchange

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* This research was funded by Australian Research Council Large Grant A10009141.

markets to keep the dollar broadly in line with 'the fundamentals', has no real idea of what is happening. In a speech on November 9, the Governor started by saying:

> The exchange rate has behaved during 2000 in a way that no-one predicted. There used to be some elements of predictability for the Australian dollar in that its broad movements could usually be explained by changes in our terms of trade (or its close relative, commodity prices) and the difference between domestic and foreign interest rates. . . [O]n the basis of previous experience during the floating rate period, we could have expected a rise in the exchange rate in 2000. Instead, we have seen a fall and the gap between actual and predicted is over three standard deviations - the largest in the past fifteen years. Something therefore has changed, at least for the present. (Macfarlane 2000:1)

The Governor then proceeded to refute a series of popular *ad hoc* explanations for the fall of the dollar - lack of new economy activity in Australia; the Australian dollar is now attached to the euro, not the US dollar; the market is reacting to mounting foreign debt, etc.. These explanations look pretty weak and are either instantly disproved or lack even cursory verification.[5] The Reserve Bank's admission of confusion is at least honourable, if not particularly reassuring.

A shift in mindset is needed in order to recognise that exchange rates are not just reflections of the so-called 'real' economy. When the dust settles, there will be no way of ignoring the need to re-think that relationship.

The *Australian Financial Review* of September 13 provided a symbolic statement of the problem that needs re-thinking. On page 1 was a story about the falling Australian dollar – that day's particular issue being a proposal for currency unification between Australia and New Zealand. In the centre of the paper, with no reference at all to the on-going decline of

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5 Indeed, the argument about the euro was disproved as the AUD and the euro uncoupled at the beginning of November. The argument about foreign debt also seems to ignore that the United States is itself the largest debtor nation in the world (and running historic current account deficits), while the new economy argument seems to be using a long-run issue that has been discussed and debated for many years (especially in this Journal) as an explanation for a short run phenomenon.

the Australian dollar, was a five-page supplement on Capital Markets.[6] That supplement included articles on the following issues:

- the record level of capital raising by Australian companies;
- the huge growth in the issuance of mortgage-backed securities;
- record levels of corporate bond issuance;
- the record widening of the basis-swap spread between the Australian dollar and other currencies and its impact on cross-border bond issuance between the Australian and US dollar markets.

Surely all these activities considered in the *AFR* Capital Markets supplement were exerting an influence in the issue of the front page story – but no connection was made. Making that connection requires overturning the standard explanations of exchange rates.

That connection is starting to be made. A recent paper by economists at HSBC (an adumbrated version of which appears as the earlier contribution to this forum by John Edwards) provides a critique of existing exchange rate models, seeking to shift the emphasis to capital flows and especially the increasing weight and changing nature of Australia's foreign financial liabilities. In particular, the growth of Australian dollar-denominated bonds issued in international financial markets is noted as an important impact on the Australian dollar.

The difficulty, however, is in relating the global role of the national currency back to national explanations. For the HSBC economists, it comes down to the balance of payments impacts of the international role of the dollar.

The focus on the global role of currencies is germane, but the national significance is less apparent. One of the consequences of currencies breaking out of their tight national attachment is that activity in the currency cannot be read from the balance of payments: there is simply too much activity occurring off balance sheet, from a balance of payments perspective, to rely on balance of payments evidence to depict the forces determining the value of the dollar.

6 Someone looking for an applied explanation of international financial markets could well find this supplement informative.

Two points here are important in relation to the current decline of the dollar. First the process of bond raising in Australian dollars is not unique to the Australian dollar: it is part of a global trend applying to many currencies (Fornai and Levy 2000). Yet it is not leading everywhere to steady devaluations. There needs to be more to the story of devaluation than a growth of external liabilities.

Second, we argued in our 1999 book (Bryan and Rafferty 1999, ch.8) that the Australian dollar is becoming disconnected not just from the geographic space of Australia, but also from Australia as an economic entity. The growth in 'Australian' companies borrowing off-shore in non-Australian dollars, of 'non-Australian' companies issuing international bonds denominated in Australian dollars, and of 'non-Australian' companies borrowing in the Australian capital market are all mounting evidence that the Australian dollar is being increasingly used in activities that have nothing particular to do with 'the Australian economy'. Add to that the reality of active swapping of currencies associated with most debt and equity transactions and the picture that emerges is that there is no picture – no coherent depiction of the Australian dollar that relates systematically to Australia.

There is now a large offshore market for Australian dollar: around 60% of transactions in the Australian dollar occur offshore, and the Australian dollar is the fifth most traded currency in the world.[7] These offshore transactions need bear no relation to Australia even though they may now 'fundamentally' impact on the value of the dollar.[8]

7 Cohen (1999) has noted that the global 'physical' circulation of currencies is quite extensive, and that as much as one-quarter to one-third of the world's circulating currently is located outside its country of issue. Our point is that financial claims denominated in several key currencies are even more significant, such that for instance, more US dollars (especially US dollar denominated financial assets) are traded in London every day than in the whole of the US.

8 Although the significance of autonomous off-shore transactions on the value of the dollar is debatable, it is interesting to note that US Federal Reserve Governor Laurence H. Meyer (1999) prediced the future of the euro to be determined by its role as an asset-holding currency:

"[T]he international financial consequences of the euro will be driven most importantly to the extent euro-denominated assets play a growing role in global portfolios, displacing to some degree the role of dollar-denominated assets."

The difficulty of understanding the effect of the offshore trading in the Australian dollar (and the concentration of that trading in derivatives like swaps) has another dimension. It is now difficult to know the effect of the exchange rate depreciation on individual companies. Many companies with exposure to the US dollar have hedged their exposure for up to two years ahead, while others have not (*AFR* 2000b). [9] As a consequence there are problems in interpreting official foreign debt figures and exchange rates. These problems have been observed in a recent RBA study of the largest international borrowers of recent years: banks and other financial institutions (RBA 2000). The study concluded that official statistics about foreign exchange exposures offered a quite misleading guide to the likely effects of exchange rate movements. Specifically, it found that by hedging their international borrowings and other off-balance sheet activities, banks had shifted almost all their foreign currency exposure.

The problem for on-going analysis and debate about the national impacts of exchange rates is that information on these activities was obtained by the RBA only by direct inquiry. It is not available from company annual reports or other publicly available sources.

The analysis presented here does not 'explain' recent exchange rate movements. It attempts to shift the focus of attention to an area where important things are happening. There is, however, a common theme of almost all the analysis of the exchange rate. Whatever the diagnosis, the prescribed cure is more or less a shared one. And it is an all too familiar one: reduce government spending (at least on wasteful areas like health care and welfare), decrease the deficit (or its Y2K equivalent, increase

8 (cont.) He explained the 9% depreciation of the Euro immediately after its 'debut' in terms of a failure of investor portfolios to shift from US dollars to Euros as their preferred currency.

9 Further, in the case of a company like News Corp, which has about 60 percent of its revenues denominated in US dollars, it is increasingly the US dollar which forms the base currency for its global operations. Far from currency transactions associated with protecting fund raising, investment and earnings being speculative, in a volatile currency market active currency trading may be seen as a necessity. And indeed if, for example, News Corp. or the banks decided not to hedge their Australian dollar/US dollar exposure, this would presumably reduce demand for Australian dollars and thus exert a downward pressure on the Australian dollar.

the surplus), and particularly keep a lid on wages and inflation. As Paul Krugman (1999) observed, despite remarkably good economic conditions in the US, Federal Reserve Chairman Alan Greenspan has become increasingly explicit about the fact that the operating target of monetary policy is keeping wage growth down. For Greenspan, the problem has been that, with a booming economy and tight labour market, workers might start rachetting up pay demands. Remarkably, they haven't, and perhaps if there is anything 'new' about the new economy it is that in this economic boom a large 'reserve army' of labour does not seem to have been required to keep those in work meek and humble. Insecurity is incentive enough.

This focus of monetary policy on labour and wage growth in particular has always been there, it was just that, until recently, it was usually implicit and couched in terms that only fellow economists and their ilk could understand. 'Greenspan, to his credit, tells the truth about what he does,' says Krugman of monetary policy in the US, 'but until now, he has done it in a way that only the *cognoscenti* can understand'. While the liberal Krugman grudgingly accepted that monetary policy has to be deployed to limit job growth and keep people insecure in their current work as a means of wage control, he ended by wondering whether America is ready to hear this message (that monetary policy has an explicit class agenda). But a further question for readers in Australia is why economists in a country like the US, with a booming economy and strong exchange rate, seem to be reading from the same policy script as a country with an exchange rate in steady and unexplained decline.

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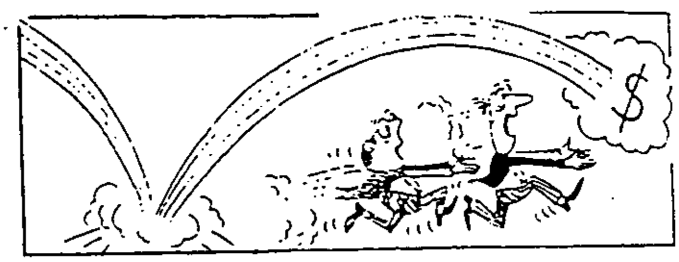

DOLLAR DOWN: UNCERTAINTY UP

Frank Stilwell

The international value of the dollar seems rather remote from most of our everyday lives. Only those who have been speculating in international currency markets, trading goods and services internationally, or taking overseas holidays are directly affected. But all of us are indirectly affected by the changing prices of imported goods, by higher interest rates and the changing conditions in the Australian economy. So the dive in the Australian dollar during 2000 has important implications, irrespective of whether the 'little Aussie battler' stages a partial recovery in 2001.

What the financial market analysts seem generally too coy to emphasise is that the overwhelming majority of transactions in currency markets are purely speculative. It is that feature which accentuates instability, because the patterns of buying and selling in speculative markets tend to have 'herd' characteristics. When speculators see something has a falling price (triggered off by some event, however arbitrary) they usually sell it, unless there are grounds to expect that its price will quickly bounce back to its preceding level. That causes the price – the mechanism that adjusts to changes in supply and demand – to fall further. A viscious circle develops. It is presumably only an ultimate connection to some sort of economic 'fundamentals' – what currencies buy in terms of real goods and services, for example – that prevents complete 'free fall'. Also uncertainty about when a market has 'bottomed out' typically leads some speculators to continue buying, going against the trend, and if that occurs in sufficient volume the trend may be reversed; the expectations become self-fulfilling and the downswing becomes an upswing.

Financial markets do have their own logic of sorts, but it is the logic of a casino. It is pertinent to recall the observation of J. M. Keynes (1936:159) that 'when the capital development of a country becomes a by-product of the activities of a casino the job is likely to be ill done'.

In practice the situation is further complicated by *interdependence* between speculation and the economic 'fundamentals'. This effectively undermines any claim that these 'fundamentals' have objective characteristics. The problem results from what George Souros (1998), himself a renowned international financial speculator, calls 'reflexivity' in market behaviour. The changes in market prices interact with the expectations of the market participants, changing their behaviour and thus changing how the economy as a whole functions. In this case, the lowered value of the dollar impacts on the levels of exports and imports, on the prevailing rate of inflation, on the output of goods and services and in employment levels, so these 'fundamentals' are themselves changed by the speculative process.

The financial analysts tend to emphasise the up-side of this 'reflexivity' (while, inconsistently, still treating the notion of economic 'fundamentals' as unproblematic). They make much of the opportunities for our export industries to increase their sales, because the products of these industries have become cheaper on world markets as a result of the lower value of Australian dollar relative to other currencies. That, they argue, should help in the competition with other firms in international markets for real goods and services. However, the volume of export sales has to rise proportionately more than the fall in the value of the currency for there to be a net increase in sales revenue in terms of Australian dollars earned. The demand for the products must be elastic. In respect of wine exports, for example, sales must be strongly responsive to price differentials, with international consumers being relatively free from brand loyalties or other impediments to switching their purchasing patterns. It ain't necessarily so. In other words, the greater 'competitiveness' due to the fallen dollar does not necessarily translate into higher export earnings.

Meanwhile, imported goods are now relatively more expensive. If that causes Australian consumers to stop buying them, that could improve the nation's trading balance. But that is a big if. In some cases there are no locally produced substitutes: the inadequacy of Australian industry policy has let some industries go to the wall. Tractors, for example, have to be imported, whatever the price, because there are no major Australian manufacturers. In other cases, consumers may just carry on buying the imported goods (perhaps unaware of the relative price changes, perhaps confused by the coincidence of the price changes coming at about the same time as the introduction of the GST, or perhaps just because of a continuing loyalty to the familiar brand they have bought regularly before). Again it is a matter of elasticities. If the demand for imports is relatively inelastic – and there are good grounds for thinking this to be so in many cases – the lowered value of the currency tends to cause both an inflationary impact and an adverse effect on the overall current account deficit.

This general inflationary stimulus coincides with the specific effects of the rising price of imported oil. The sky-rocketing petrol prices in 2000 have been a major contributor, both directly and indirectly, to a significant inflationary surge. Inflation has not been a problem for over a decade now, but this situation now looks increasingly unsustainable.

Therein lies a further problematic connection with interest rates. The conventional response of the monetary authorities, facing a resurgence of inflationary pressures, is to raise the prevailing rate of interest. The Reserve Bank has already done so five times over the last fifteen months. The intention has presumably been to choke off the 'excess demand' and thereby to reduce the rate of economic growth. The policy is fundamentally misconceived to the extent that the inflationary process is driven, as I have argued, by a 'cost-push' rather than a 'demand-pull' process. Moreover, such a policy has potentially very damaging effects – increasing unemployment, raising the costs of investment, and hitting hard at those trying to pay off their loans, particularly home buyers. Some lessons have evidently been learned from the economic recession of 1990-1 when very tight monetary policy was a major contributory factor. This time the RBA has been trying to be gentler with its 'dabs on the brake': but there is always the possibility that these may lead to a crash down the track. Meanwhile, even the modest interest rate increases in 2000 have adverse effects on the housing industry and on small businesses. Those parts of regional Australia already facing relative economic stagnation or decline are particularly vulnerable to changes in monetary policy.

For the nation as a whole, the lowered value of the Australian dollar has also intensified debt repayment problems. To the extent that the foreign debt is set in terms of US dollars, the effect is to raise the interest repayments in terms of Australian dollars. A significant proportion of this burden falls on corporations because they account for much of the total foreign debt, but some falls as a burden on government finances. That has broader implications for the capacity of governments to reduce taxes and/or increase expenditures on social services and much-needed public infrastructure. Given that our federal government leaders are ideologically opposed to those sort of social expenditure programs anyway, they are likely to use the reduction in the value of the dollar as an excuse for even more cuts. Health, education and social security policies are the obvious targets. The current fiscal surplus provides some temporary cushion, but if the rate of economic growth slows significantly and unemployment starts to rise again, that would be quickly eradicated.

So there are plenty of reasons to be concerned about the value of the currency. A plunge in the value of the currency can evidently have adverse social consequences, magnified by the responses of the monetary institutions and a conservative government seeking excuses to prescribe stiffer doses of 'economic rationalist' medicine. Contrary to the impression given by some financial journalism, the dollar's value is **not** a symbol of the overall health of the economy. Its value depends more on the activity of speculators than on any economic 'fundamentals' and, as I have argued, these 'fundamentals' themselves are affected by the consequences of the speculation. One outcome is that the resurgence of 'stagflation' – simultaneous inflation and unemployment – has become a real threat as we enter 2001.

The situation in the US economy is particularly important in this respect. It was the buoyancy of the US economy in 2000 that was a principal factor in the relative decline in the value of the Australian dollar. If growth in the US economy falters in 2001 that might make the Australian dollar look relatively better, but only at the expense of more generalised economic difficulties. The US sharemarket is considerably over-valued, according to most commentators, so a correction or even a crash can be expected eventually. Fears of a major recession are growing.

What can be done? The situation in the USA is beyond our influence, of course, and the effects of trade liberalisation, deregulation of finance and the globalisation of capital have effectively eradicated the major local shock-absorbers. Reserve Bank intervention in the foreign exchange market remains one means of trying to 'prop up' the value of the

Australian dollar. In the past, this has been a source of income for the Reserve Bank, because where such intervention is successful in raising the value of the dollar in the market the Bank makes a profit. In this respect, intervention can have double benefits – ameliorating market volatility and generating income. However, as experience in 2000 shows, it is also a risky strategy because, if the Bank's purchasing fails to significantly offset the effect of the widespread speculative selling which is pushing the dollar's value down, the nation's reserves are depleted.

More fundamentally, the need is to eliminate the speculation in currencies which compounds the problem of economic instability. The trend has been for financial speculation to outstrip more economically and socially productive use of investable funds. It is a trend with major consequences for the distribution of incomes as well as system-stability world wide. It has to be controlled. One means of doing so, which is the focus of growing interest internationally, is a tax on currency transactions. This so-called Tobin tax would be a means of discouraging that trend to ever more speculation (see ul Haq, Kaul & Grunberg, 1996). However, it seems to be a remote possibility at present, given the powerful international political economic interests that are opposed to it.

For an individual nation like Australia, increasingly integrated into the globalisation of capital, there is no easy short run solution to what is a transnational phenomenon. However, it is possible to develop economic policies which give a greater degree of insulation against the vicissitudes of international capitalism. Policies to more effectively channel domestic savings into productive investment, for example, would reduce dependence on capital inflow. A focal point could be the establishment of a National Investment Fund, pooling the savings currently in superannuation schemes, and using that finance to promote more balanced industry development. This could be targeted, for example, at restructuring industry to achieve greater ecological sustainability and to generate 'green jobs'. Creating a sounder economic base is ultimately the best safeguard against the volatility of markets. It would not eliminate currency fluctuations but would make our economic well-being less vulnerable to them. It could be a significant element in an alternative political economic strategy (further discussed in Stilwell 2000).

Whatever happens to the value of the Australian dollar in year 2001, there are important lessons to be drawn. The dollar may well rise in value again, but this provides no general solution to the problems revealed by its fall in 2000. The general lesson is that addressed in the earlier quotation from Keynes. Economic well-being depends on having diversified, productive and sustainable industries. Exchange rate instability fuelled by speculative processes diverts attention from those more important priorities. It is symptomatic of the economic rationalist obsession with 'free markets' at the expense of more secure economic foundations. The dive of the Australian dollar in the last year is further evidence of the failure of the neo-liberal experiment in economic policy.

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