SEANZA Governors' Symposium
2 November 2002, Hong Kong

Meeting Note

The Symposium
Theme: Asset Price Cycles and Financial Stability

1. Mr. William White, Economic Adviser and Head of Monetary and Economic Department of the Bank for International Settlements, delivered his presentation, highlighting the legacy challenges for policymakers in the post-war period. The reliance on demand side stimulus to fulfil the objective of increasing output in 1950s and 1960s was followed by high inflation in 1970s. In the 1980s, the recycling of money to the emerging markets and the subsequent financial shocks in such markets, together with property crises in industrial countries, contributed to the legacy of debt problems in the 1990s. During the last decade, in response to the initial financial headwinds in the US and Japan, the subsequent financial crises in Mexico and in East Asia, the LTCM and Russian crisis, and more recently the collapse of the NASDAQ, initial interest rates were either reduced or maintained at a low level. These experiences in the past decades generated an observation that price stability might still have opportunities for financial instability.

2. Mr. White also identified the pathology of financial cycles. Typically, expectation of greater profit opportunities would result in high credit growth and rising asset prices and investments. The succeeding stages often set in when rational exuberance became irrational. Bubbles previously built up then turn to bust, thus ending up with financial stress. With low inflation prevailing even at the peak stages, the financial headwinds in the downside of the cycle might raise the risks of deflation.

3. The measures for preventing and managing financial crises were classified under two categories by Mr. White. Micro-prudential measures covered the use of regulatory arrangements to strengthen financial systems and resist procyclicality, while macro-prudential measures were those implemented through the use of exchange rate and monetary policies. It was believed that each measure had its own pros and cons. Monetary easing in the face of excessively disinflationary forces, particularly if accompanied by weakness in the financial system, had an obvious appeal. While fiscal expansion could well be a policy

response in the aftermath of financial crisis, a credible medium term fiscal plan would help mitigate the potential for associated problems of high interest rates and non-sustainable increase in government debt. Corporate restructuring and the restoration of profits were also keys to rapid recovery from a crisis.