Opening Speech

Masaru Hayami, Governor, Bank of Japan

At the 10th International Conference

held by the Institute for Monetary and Economic Studies, Bank of Japan

July 01, 2002

It is my great pleasure today to address the 10th international conference hosted by the Institute for Monetary and Economic Studies. On behalf of all my colleagues here at the Bank of Japan, I welcome all the participants. And my special thanks to the Institute's two advisors, Professor Allan Meltzer and Professor Maurice Obstfeld. You have done a wonderful job helping us organize the conference.

This is the first conference in the 21st century, and for such an occasion my colleagues chose 'Exchange Rate Regimes in the 21st Century' as the theme. Exchange rate regimes among major countries experienced several changes after World War II while fulfilling their expected role of enhancing cross-border trade and investment as well as encouraging world economic growth and preserving price stability.

Being a central banker, I was also involved in changes in exchange rate regimes. On Sunday, August 15, 1971, when U.S. President Nixon announced that the US would no longer convert the dollar into gold, I was stationed in the London office of the Bank of Japan. And I still vividly remember that on the following day, Monday, with Bundesbank Vice-President Emminger, I took part in a confidential meeting with US Treasury Undersecretary Volcker. He had flown over to London to explain to the

European monetary authorities the President's announcement.

Most of the major countries, except Japan, closed their foreign exchange markets after the announcement. European participants, who broke the ice at the meeting, said that they could not re-open their markets until the US decided the new parity of the dollar. For monetary authorities at that time, the adoption of floating exchange rates was not like the dawn of a new era with full confidence. The then BIS President Zijlstra termed the trial and error among authorities under the floating exchange rate regime "a voyage through uncharted waters," and that was how all the monetary authorities felt.

Some 30 years have passed under the floating regime and now we have two challenges for the regime to meet.

First, we have to work out how to preserve foreign exchange rate stability between major currencies. The dollar has functioned as a key currency under the floating exchange rate regime. Its exchange rate on other major currencies, however, has by no means been stable.

I have had a hard time, sometimes as a central banker, and sometimes as the head of a trading company, dealing with fluctuations in foreign exchange rates.

In the meantime, EU countries made efforts to stabilize foreign exchange rates between member countries and such efforts paid off at the end of the 20th century. They gave birth to a single currency, the euro.

The euro will no doubt contribute to enhancing trade and investment within the region and will be a model for other regions in the world. And it will take some time to get clues to what extent the euro will play the role of a key currency and lead to the stability of foreign exchange rates between major currencies.

I should also add that we might need to review the background history and rationale behind the special drawing rights (SDR) of the IMF which were created in 1969.

The other important challenge in the 21st century is how we can devise the exchange rate regime in order to stave off currency and financial crises in the emerging economies and also how to contain resultant contagion to the minimum.

We understand that the past currency crises in Latin American and Asian countries were brought about by individual and unique factors. Still, we have no choice but to make steady efforts to learn from the past crises in various countries in order to ward off currency crises and contain contagion. I am told that this conference will take up such issues related to currency crises and I am convinced that your discussions will provide a good opportunity to enhance our understanding.

A better understanding of an ideal exchange rate regime may not lead to a universal currency system all the countries around the globe accept. I have several times witnessed a currency system, once optimal for a certain country at a certain time, gradually become fraught with inconsistencies and unstable in time.

Yet, pessimism is not what I want to spread. A series of inconsistencies in the international currency have, in my judgement, deepened our understanding of the functions and roles of an exchange rate regime and have encouraged the evolution of such a system. To rack our brains and map out ways to achieve a better exchange rate regime is one of the most important challenges for central bankers.

I am convinced that with the experts from all over the world exchanging their experiences and views, this conference will contribute to meeting such a challenge. And I believe this conference will also provide clues to how to map out charts through troubled waters.

Thank you for your attention.