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HEDGE FUNDS

RESERVE BANK GOVERNOR BACKS MAHATHIR ON HEDGE FUNDS

By: Neville D'Cruz

MELBOURNE, November 26 (Bernama) -- The Governor of the Reserve Bank of Australia (RBA) Ian Macfarlane has echoed the criticisms of Prime Minister Datuk Seri Dr Mahathir Mohamad on the role played by hedge funds in the Asian economic crisis.

Speaking to the Committee for Economic Development of Australia here on Wednesday, Macfarlane said: "The hedge funds have become the privileged children of the international financial scene, being entitled to the benefits of free markets without any of the responsibilities."

He said hedge funds, able to borrow and spend extremely high levels of funds using a narrow capital base, had already wreaked havoc in the Australian currency market, where the Australian dollar was driven to a 12-year low against the greenback in June and, again in late August/September.

Macfarlane said there was widespread agreement within the Western policy establishment that major changes were needed to improve the international financial system.

"The degree of instability, if it continues unchecked, could lead many participating countries to question the whole legitimacy of the system.

"The severity of the contractions in Asia is the most striking example, but so is the sudden recognition that a hedge fund can become so important that its failure could pose systemic threat to the United States and the international economy.

"The fact that the second most important exchange rate in the world, the US dollar/yen rate, could move by 20 percent in a month without there being a material change in fundamentals, has caused concern," he added.

Macfarlane also said the efforts to salvage the international financial system could still falter.

"It would be tragic if our failure to reform an unstable international capital market resulted in a return to inward-looking policies in the international trade of goods and services," he pointed out.

"And, that may yet happen. One reaction to the instability of the international financial system would be for countries to unilaterally impose quite restrictive controls on inward and outward capital movements, and thus miss out on the benefits access to foreign capital can provide.

"We have already seen this starting, and it would be regrettable if it were to spread.

"Even if this does not happen, there is still a possibility of other reactions which may be equally, or more, unhelpful to the world economy. "

"In particular, I fear that a number of emerging market countries will take another form of safety-first policy by building up large international reserves, a new type of mercantilism," Macarlane said.

He accused the International Monetary Fund (IMF) of overstepping the mark in the conditions it applied to rescue packages for countries hit by the Asian economic crisis, adding that there was a need for a fundamental re-evaluation of the role of agencies like the IMF and the Bank of International Settlements.

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