EBD/83/317

December 12, 1983

To: Members of the Executive Board

From: The Secretary

Subject: Australia - Exchange Arrangements

There is attached for the information of the Executive Directors a paper on a change in Australia's exchange arrangements.

Att: (1)

Other Distribution:
Department Heads

INTERNATIONAL MONETARY FUND

Australia--Exchange Arrangements

Prepared by the European Department and the Exchange and Trade Relations Department

(In consultation with the Legal Department)

Approved by L.A. Whittome and S. Mookerjee

December 12, 1983

In the attached communications dated December 9 and 11, 1983, the Australian authorities have informed the Fund of a change in Australia's exchange arrangements. With effect from December 12, 1983 the Reserve Bank has discontinued announcing indicative exchange rates for the Australian dollar in terms of the U.S. dollar, based in part on a trade-weighted currency basket, and will permit both spot and forward exchange rates for the dollar to be determined by the market. The Reserve Bank will not generally be intervening in the foreign exchange market, but will retain the discretionary power to do so. Since November 29, 1976, the Australian dollar had been managed flexibly with reference to the currency basket. On October 28, 1983 the arrangements for determining the spot and forward exchange rates for the Australian dollar were changed to allow greater flexibility, 1/ thus presaging the present measures. On that date, commercial banks were permitted to hold foreign currency balances or to incur foreign currency liabilities, within limits established for each bank. The limits have been retained in the new arrangements.

Also with effect from December 12, 1983, Australia has liberalized certain exchange controls affecting capital flows, consistent with the floating of the exchange rate. The major changes are the removal of: (1) restrictions on the timing of trade and other current payments; (2) the requirement that residents needed Reserve Bank approval in order to enter into contracts with nonresidents; (3) remaining restrictions on overseas portfolio and direct investment by Australian residents; (4) restrictions on lending to nonresidents; and (5) restrictions on the holding by nonresidents of foreign currency-denominated balances with Australian financial institutions. Previously, all transfers of capital from Australia required approval, and lending overseas by residents was confined to direct investments approved on a case-by-case basis. The remaining exchange controls are described in Attachment II. Broadly speaking, exchange controls will be retained on investments in Australia by governments, government agencies, and foreign banks (including central

1/ Australia--Recent Economic Developments (SM/83/225), November 4, 1983, pp. 92-94.

banks), and Australian banks remain the only institutions authorized to deal generally in foreign exchange. Although it will be readily given in most cases, clearance with the relevant authority will continue to be required for a range of foreign financial transactions, for tax screening and foreign investment policy purposes.

On the first day of the new arrangements, the exchange rate for the Australian dollar opened at $A 1.0905 = US$1, representing a 1.6 percent appreciation from the midpoint exchange rate of $A 1.1080 = US$1 on Thursday, December 8. The appreciation has marginally eroded the improvement in competitiveness that occurred over the past year or so and which was noted in SM/83/225.

The Australian authorities have stated that this action was necessitated by large speculative capital inflows that had disturbed domestic monetary conditions, and was expected to continue to do so. Australia's exchange rate and other policies were discussed by the Executive Board, on November 23, 1983, in the context of the 1983 Article IV consultations with Australia; it was then noted that it was preferable that increased competitiveness be sought by domestic cost and price restraint rather than by exchange rate depreciation. The floating of the exchange rate and the liberalization of the system of exchange controls are fully consistent with these objectives, and in the opinion of the staff are actions that should assist both domestic and external stabilization.

Attachments

ATTACHMENT I

TO: Mr. Whittome

Date: December 9, 1983

FROM: A.R.G. Prowse

SUBJECT: Floating of the Australian Dollar

At 6.00 pm on 9 December (Australian eastern standard time) the Australian Treasurer, Mr. P.J. Keating, announced the Australian Government's decision to float the Australian dollar and to make related changes to exchange controls, with effect from the opening of business on 12 December. It has not been made clear to me that the new rules will apply to business being conducted in Australian dollars today in New York and London but presumably that would be the case.

2. The text of the statement by Mr. Keating follows:

"Last night the Government decided to ask the Reserve Bank to suspend dealings by trading banks in foreign exchange except for bona fide travellers and other small personal transactions.

This action became necessary because of the continued high level of speculative capital inflow and advice that the inflow was expected to intensify.

On October 28 the Prime Minister and I announced certain adjustments to the exchange rate management system. These were designed to deal with the problem of intra-day speculation and were generally in the direction of a more market oriented system, particularly for forward transactions where the rate was allowed to float. The Government also had in mind that those changes would give the banks and other market participants useful experience in operating in a less regulated environment.

The Government has now decided to take these changes significantly further by allowing the spot market, as well as the forward market, to float. The Government has also decided to abolish a major part of the existing exchange controls.

This means that the Reserve Bank will no longer announce the trade weighted index or indicative exchange rates for the Australian dollar and the U.S. dollar. Nor will the Banks be required to settle their foreign exchange positions at the end of each day.

In future exchange rates will be determined by the market.

These reforms of the exchange rate management system will also assist the conduct of the Government's monetary policy.

In my budget speech, I indicated that the Government's monetary policy would be assisted by monetary projections.

On the information available to us at the time of the Budget, we considered it desirable for the growth in financial aggregates between the June quarter of 1983 and the June quarter of 1984 to be consistent with M3 growth in the range of 9 to 11 per cent.

I said then that monetary policy cannot focus solely on M3, and that we would be monitoring the progress of financial aggregates with coverage both narrower and broader than M3.

I said in my Budget speech that the projection was a conditional one: that it would be reviewed during the year in the light of trends in activity and other relevant developments. I also indicated that we would aim to move the rate of monetary growth gradually within the projected range.

Since the budget we have managed monetary policy in line with these statements.

The recent inflow of foreign funds has pushed M3 off the path of 9-11 per cent growth in 1983/84. Until last week, monetary growth within the financial year was within the projected range. The rate of growth has now been boosted beyond that range.

The new exchange system should mean that external transactions are no longer a major aberrant factor in determining monetary growth.

The effects of the recent capital inflows and reactions to the changes in the management system will need to be taken into account in our review of the monetary projection.

The fact that real growth in output is stronger than anticipated at the time of the Budget, as indicated by recent statistics, it is also highly relevant to the review of the projections.

In these new circumstances, the review of the monetary projections will take place as soon as possible.

Details of the new arrangements for exchange control are attached.

Exchange Controls

Exchange control restrictions are being relaxed in a number of areas, consistent with the new foreign exchange arrangements. Those controls which relate to tax havens and foreign investment policy will be retained. Restrictions will also continue on the holding of balances in Australia by foreign official institutions and banks.

The main changes which will be made are:

- Restrictions on the timing of trade and other current payments (leads and lags) have been removed;

- residents will no longer require Reserve Bank approval before entering into any contract with a non-resident;
- remaining restrictions on overseas portfolio and direct investment by Australian residents have been removed;
- loans to non-residents will be permitted; and
- financial institutions in Australia will be permitted to offer foreign currency denominated accounts to their clients.

For the time being applications for approval in terms of the banking (foreign exchange) regulations will still be required for the bulk of overseas transactions even when approval will usually be readily available. This is to take account of possible implications of overseas transactions for the Government's tax screening and foreign investment policies. The Reserve Bank will be issuing detailed instructions as soon as possible.

A number of consequences will flow from the changes being made to exchange controls.

Investment by Australian residents on overseas commodity futures markets will be permitted on the same basis as fixed interest investments. This should remove many of the difficulties faced by those seeking to establish active bullion and commodity futures markets in Australia. There is no longer a need, for exchange control purposes, to restrict Australian banks in their dealings between foreign currencies."

3. I presume that you will arrange for the appropriate notification of these changes to the Executive Directors. Please be in touch with me if there is any further information you would wish to have.

INTERFUND
WASHINGTON, DC
DECEMBER 11, 1983

The following is the text of a press release made on December 10, 1983:

Foreign Exchange Arrangements

The Treasurer announced yesterday the Government's decision to float the Australian dollar and to abolish a major part of the existing exchange controls. These changes will have effect from Monday, December 12, 1983.

Exchange Rates

Banks are free to deal with their customers in currencies at negotiated rates. Arrangements for banks to clear their spot positions to the Reserve Bank each day will cease. As announced on October 28, 1983, to allow operating flexibility, banks may hold foreign currency balances or incur foreign currency liabilities within limits established for each bank.

The Reserve Bank will no longer publish each morning the index for the Australian dollar against the trade-weighted basket of currencies (TWI) nor will it publish an exchange rate against the U.S. dollar based on that index.

Whilst the Reserve Bank will not generally be intervening in the foreign exchange market, it retains discretion to do so.

Exchange Controls

Exchange controls are being retained on investments in Australia by governments, government agencies, and foreign banks including central banks. Australian banks remain the only institutions authorized to deal generally in foreign exchange, i.e., buy and sell foreign currencies in exchange for Australian currency. No change has been made to the range of transactions eligible for cover in the banks' forward exchange market. Cover is available in that market for export and import transactions of Australian traders and some related invisibles transactions but not for capital transactions.

To meet the Government's tax and foreign investment policies, Reserve Bank consent will continue to be needed for a range of foreign transactions. Consent will be conditional on clearance by the relevant authority. The main areas affected are:

ATTACHMENT II

Australian Residents

- Foreign borrowing.

- Direct investment abroad.

- Overseas futures transactions.

- Repayments of foreign borrowing.

Non-residents

- Direct investment in Australia.

- Portfolio investment in Australia.

- Futures transactions in Australia.

Remaining exchange controls are outlined in the attachment /Annex*/

The possibility of finding other ways of providing the necessary support for government policies is being explored.

Exchange controls will no longer be applied to proceeds of exports, payments for imports, foreign currency accounts, guarantees by Australian residents, interest-bearing investments in Australia by non-residents, merchant trade transactions, and underwriting and sub-underwriting of foreign issues by Australian residents.

RESERVE BANK OF AUSTRALIA
SYDNEY

Attachment *

Received in Cable Room: December 11, 1983

Exchange Controls as at December 12, 1983

Agreements and contracts with scheduled countries: Agreements, contracts, or arrangements with residents of countries listed in the notice under Section 39B of the Banking Act 1959 require prior exchange control approval. This is available on presentation of a tax clearance certificate.

Borrowing and capital raising in Australia by non-residents (including establishment of Australian registers and listing of overseas shares on Australian stock exchanges): No restrictions apply on these transactions. Applications for exchange control approval are not required.

Borrowing overseas by Australian residents: For the time being, borrowing agreements with residents of countries listed in the notice under Section 39B of the Banking Act 1959 need prior approval. This is available on presentation of a tax clearance certificate. Borrowing agreements with residents of other countries no longer need exchange control approval. Drawdowns of borrowings need approval--applications should state lender(s), amount and currency, term of borrowing, interest rate, and purpose.

Capital repatriation: No restrictions apply on these transactions. Applications for exchange control approval are not required.

Current payments: The remittance of amounts properly due to non-residents is readily authorized for items of a noncapital nature such as interest, dividends, service fees, or royalties. For the time being, approval is needed for such payments. For amounts in excess of Dlrs 10,000, applications must be completed. For smaller amounts details must be provided to the bank handling the transaction.

Direct investment in Australia by non-residents: Where a proposal is examinable under the Government's foreign investment policy, approval is given subject to any necessary clearance under that policy being obtained. In other cases, approval is freely available. For the time being, applications must be submitted.

Direct investment overseas by Australian residents: Approval is freely available. For the time being, applications must be submitted.

Donations, gifts, sustenance, trust distributions, etc.: Approval is freely available. Application forms need to be completed for amounts in excess of Dlrs 10,000. For smaller amounts, details must be provided to the bank handling the transaction.

Export proceeds: There are no exchange control formalities.

Foreign currency accounts in Australia: Financial institutions in Australia are permitted to offer to their clients accounts denominated in foreign currencies: any purchases or sales of foreign currency must be handled through a bank in Australia. The Reserve Bank may require information about these accounts at any time.

Forward exchange cover between a foreign currency and Australian currency: Transactions in forward exchange are limited for the time being to export and import transactions of Australian traders and some related invisibles transactions. Capital transactions are not eligible. Exchange control application forms are not required. Contracts between banks and their customers may be cancelled or closed out by mutual agreement.

Forward exchange cover between foreign currencies: Australian residents may enter into forward contracts between foreign currencies with a bank in Australia or direct with a bank overseas. Application forms are not required.

Futures operations: Transactions on overseas futures or similar markets need prior approval where tax clearance certificates are required. For the time being approval is also required for remittances for deposits, margins and settlements.

There are no restrictions on operations by non-residents on futures markets in Australia except where tax clearance is required.

Guarantees by Australian residents: Guarantees in Australian or foreign currency by or on behalf of Australian residents may be issued without exchange control formality.

Guarantees by non-residents: Non-residents may guarantee commercial obligations of Australian residents. If the resident is a "foreign corporation" for the purposes of the Foreign Takeovers Act 1975, the proposal may be subject to screening by the Foreign Investment Review Board as for a direct investment in Australia by a non-resident (see above).

Imports: There are no exchange control formalities.

Interest-bearing investments by non-residents: Foreign governments, government agencies, foreign banks, including central banks, may not generally invest funds at interest in Australia. Other non-residents may deposit funds at interest and make other interest-bearing investments in Australia without exchange control formality.

Loan repayments (including prepayments): Repayments of overseas borrowings are readily approved. Application forms are required for amounts in excess of Dlrs 10,000. For smaller amounts details must be provided to the bank handling the transaction.

Merchant trade: There are no exchange control formalities.

Portfolio investment in Australia by non-residents (other than interest-bearing investment): Buyers need to take account of the Foreign Takeovers Act 1975 and the Government's foreign investment policy. Applications are required but, subject to the above requirements, are readily approved.

Portfolio investment overseas by Australian residents: Australian residents may undertake portfolio investment overseas (including fixed interest investments) without restriction. Authority is required.

Travel and emigration: There is no exchange control limit on funds for travel and emigration. For amounts in excess of Dlrs 10,000 application forms are required. For smaller amounts details must be provided to the bank handling the transaction.

It remains an offence for anyone leaving Australia to take out more than Dlrs 250 in Australian notes and Dlrs 5 in Australian coin.

Underwriting and sub-underwriting: There are no exchange control formalities.

Sydney
10 December 1983