

Challenges in Monetary Policy: Implications for Central Banks.

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Topics of Discussion

- Roles of central banks (CBs) in normal time
- Roles of CBs in crisis time
- Supportive governance structure for CBs' to meet changing expectations

Roles of CBs in normal time

- Dual mandates of price stability and financial stability now widely expected of CBs
 - For EMEs since the crises in 1990's
 - For AVEs since the 2008 global crisis
- Important lessons from crises:
 - Financial imbalances/bubbles unsustainable and costly when burst
 - Less costly to lean than clean
 - Focus on price stability alone not enough

Price stability

- Price stability still the preeminent responsibility of CBs, necessary but not sufficient for financial stability
- Crisis hit both IT and non-IT countries
- IT still relevant but needs to be supplemented for financial stability

Price Stability (cont.)

- BOT, an inflation targeter, constantly monitors 7 sectors that are vulnerable to instability:
 - housing and property,
 - capital market,
 - external sector balances,
 - the financial strength or indebtedness of the banking, government, household and corporate sectors

Financial Stability

- No single indicator for easy identification of bubbles
- Alternative: Monitor variables that give early warning and stress test to assess impact should risk materializes (credit growth → house prices up → likely hood of house prices down → impact on banks/ households/ housing sector/ economy)

Financial Stability (cont.)

- High likelihood and impact warrant macro-prudential measures
- Indicators may give conflicting info, individual risk but fail to flag financial instability which are of systemic nature and have multi-dimensions
- skill set for macro-prudential measures resides across many departments: policy, research, examination, supervision, money market, treasury operation, payment systems

Financial Stability (cont.)

- At BOT, a working group of these staffs meets regularly to assess the risk of potential financial instability building up
- Dialogues help identify conditions that together may expose areas of vulnerability, help foster a common culture which focuses on systemic risk and sharing of view

Financial Stability (cont.)

- Building up knowledge base and technical expertise is necessary to better understand the complexity in maintaining financial stability
- Financial stability tools usually affect only certain sectors with financial imbalances, hence CBs independence may be at risk with lobbying, resistance

Financial Stability (cont.)

- Macro-prudential tools used by BOT:
 - 2003, LTV for high-end property market and to report financing of big property development projects with loans exceeding 100 million baht per project
 - 2004, minimum requirements on monthly income and monthly payment of credit card holder
 - 2006, banks to observe the IAS39 standard on impaired asset and provisioning (two years ahead of the Thai accounting body's planned schedule for listed companies) as a countercyclical measure to build up buffers in good time for rainy days

Roles of CBs in crisis time

- Liquidity support → CBs should therefore supervise at least the core financial sector
- Balance sheet expansion → implications on P/L, independence → credibility

Supportive Governance Structure

- Independence with transparency and accountability increase credibility
- Clear legal mandates and distinct committees for different mandates make it easier to carry out tough policies
- Maintain links/ communication channels between different committees

Supportive Governance Structure (cont.)

- BOT Act, Banking Act (2008):
 - Fixed term for governor
 - BOT court of Directors (COD) is chaired by an external director. External directors are selected by Nomination Com, whose members are selected by Minister of Finance from a pool of former technocrats.
 - COD selects external members of MPC, FIPC with recommendation of governor, who chairs all policy committees to maintain the link
- More external than internal members in all committees for more transparency

Supportive Governance Structure (cont.)

- MPC, FIPC have clear mandates
- Heads of SEC, Insurance Commission sit in FIPC for info sharing