



Introduction to Monetary Policy

**Introductory Workshop to
Financial Programming and Policies
Yangon, Myanmar
January 19–23, 2015**

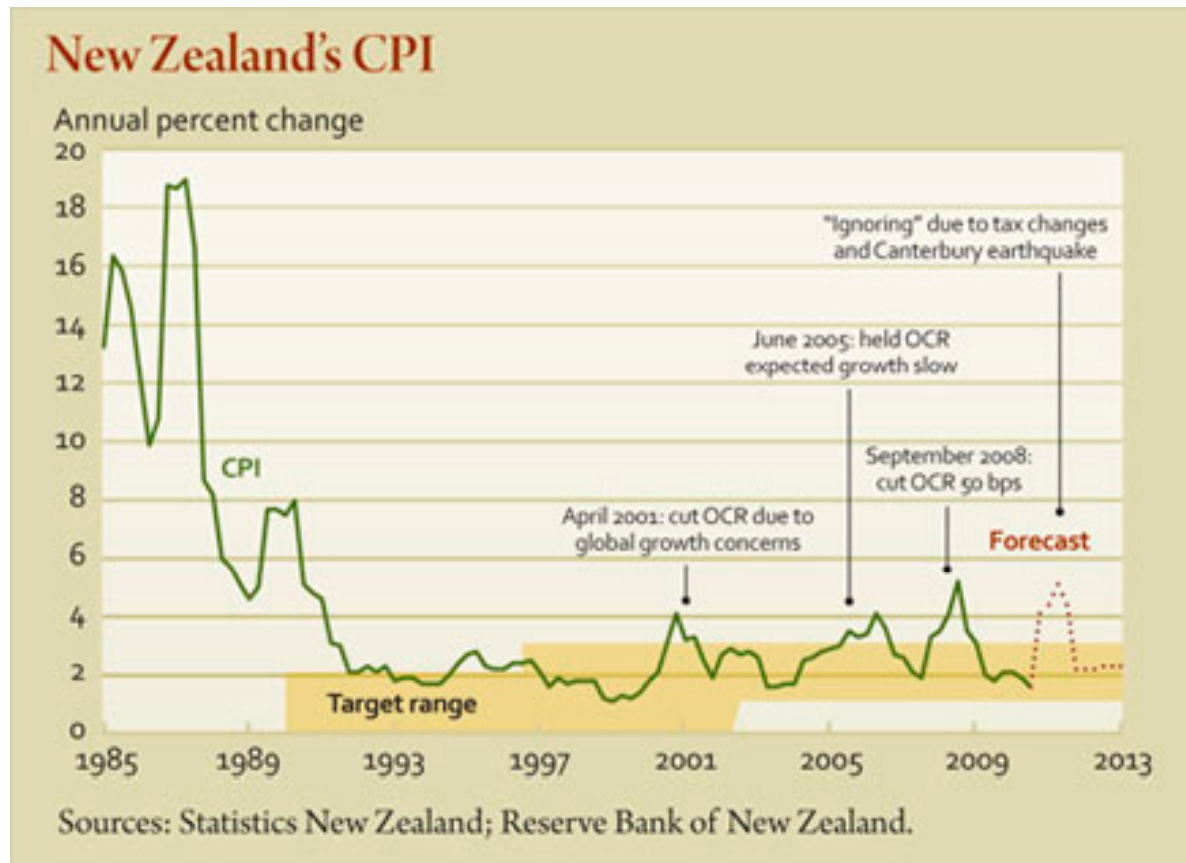
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Outline

- I. Central Bank Objectives**
- II. Monetary Policy Frameworks

Central Bank Objectives: Inflation



“...it was clearly understood that my task was to get inflation above zero and below 2%.”

Don Brash, former RBNZ Governor

Central Bank Objectives: Foreign Exchange Stability

Avoiding large, sudden foreign exchange outflows!

- Shortage of foreign exchange can lead to loss of confidence in domestic currency
- Exchange rate needs to be competitive



Central Bank Objectives: Financial System Stability

Keeping the banking system solvent!

Well-functioning credit and payment system



Central Bank Objectives & Functions

Monetary Stability

- Monetary policy
- Exchange rate policy

Financial stability

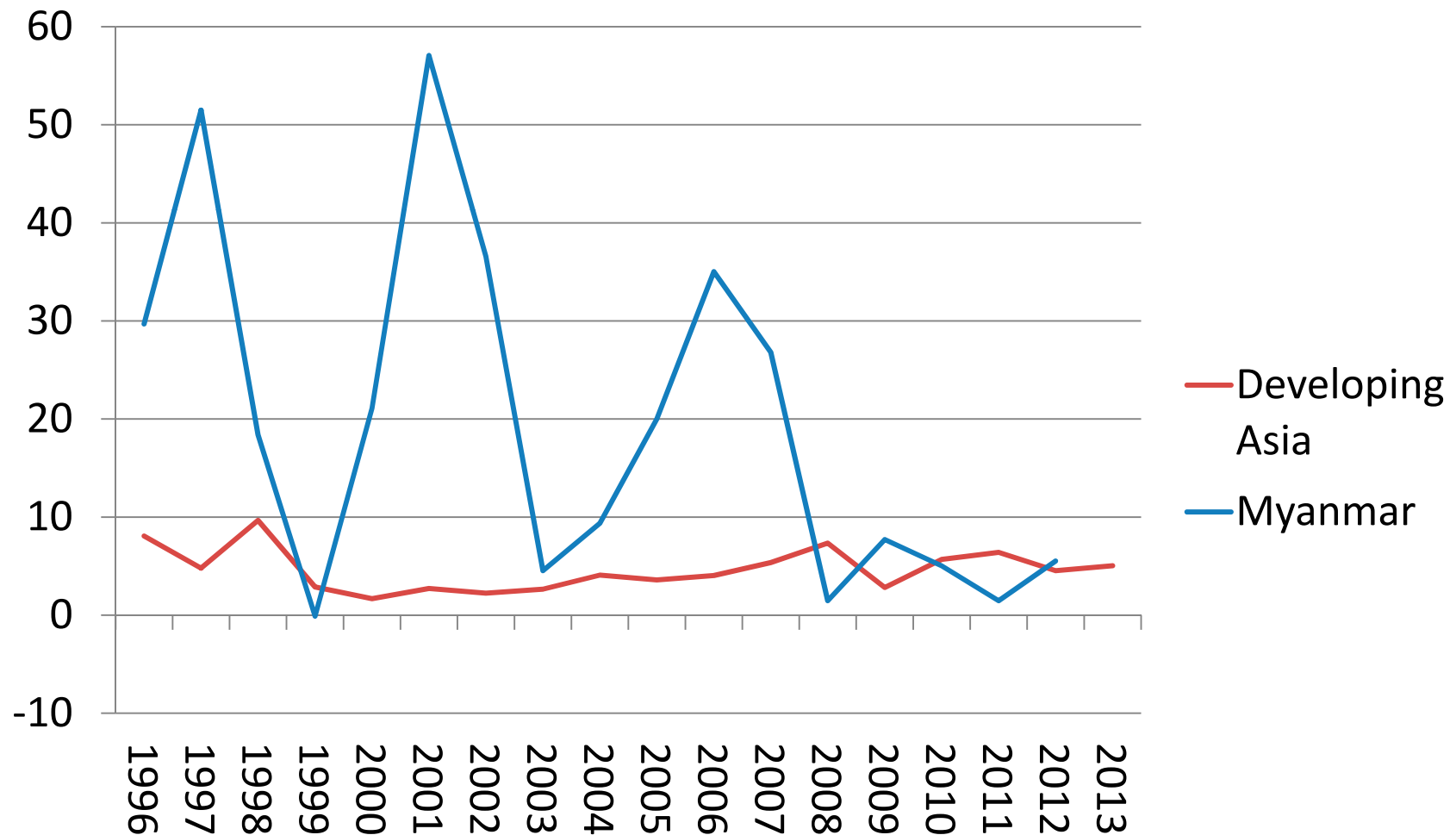
- Prudential policy
- Supervision, oversight

Policy Operation Functions

- FX intervention
- FX reserve management
- Liquidity management
- Lender of last resort

Central Bank Objectives: Historical Experience in Myanmar

Annual CPI Inflation Rates (1996-2013)



Central Bank Objectives: CBM Law

Objectives specified in CBM law

CBM Law, Chapter II:

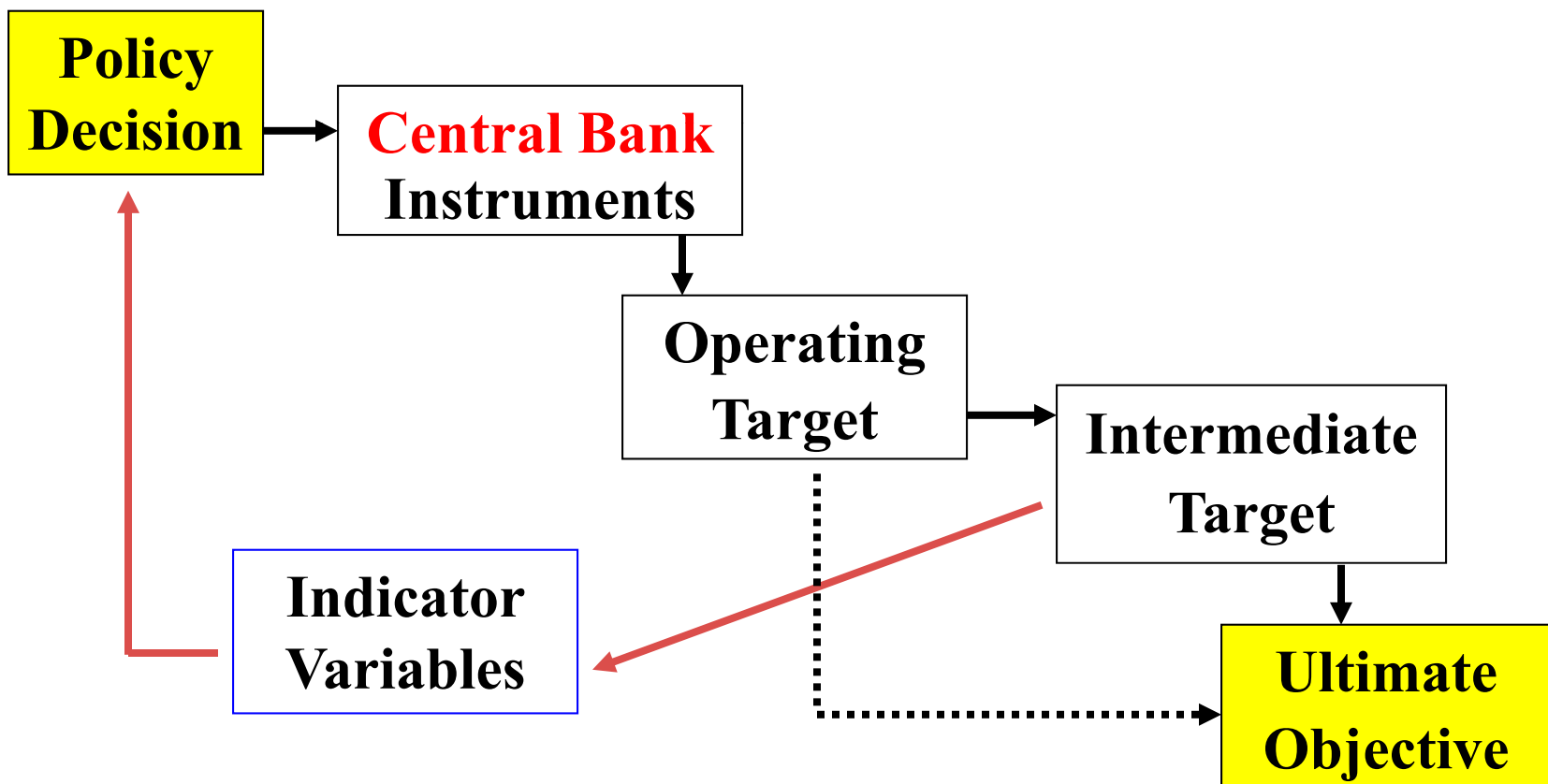
- The aim of the Central Bank shall be to maintain and preserve domestic price stability
- The Central Bank shall, in accordance with its aim, also endeavor to attain the following objectives:
 - ✓ To promote monetary stability
 - ✓ To enhance financial system stability
 - ✓ To develop efficient payments and settlement system
 - ✓ To support the general economic policy of the Government conducive to sustained economic development

Outline

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- II. Monetary Policy Frameworks**

Monetary Policy Frameworks

Central challenge for monetary policy frameworks:
Long gaps between policy decision and ultimate objective!



Role of Targets

As a result of the **long transmission lag** between central bank instrument and ultimate objective, **operating and intermediate targets are needed**

Target: proximate goals, not objectives in and of themselves; work directly toward achieving the long-term objectives of policy



Operating Targets

Operating target:
tactical goals that
the central bank can
influence in the short
run

- Reserve money/ monetary base: The central bank can control the size of its own balance sheet
- Short-term interest rates (e.g., interbank rate (“federal funds”) in the U.S.)



Intermediate Targets

Providing a Link to the Ultimate Objective

- Criteria for intermediate targets
 - Consistent with ultimate goals
 - Can be accurately measured
 - Timely
 - Can be influenced by the central bank



Intermediate Targets as Nominal Anchor

- A ‘nominal anchor’ is an intermediate target that helps to pin down inflationary expectations
- The choice of an intermediate target defines the monetary policy framework
 - Exchange rate anchor
 - Monetary aggregate target
 - Inflation targeting



Classification of Monetary Frameworks

Exchange Rate Regimes

- **Dollarization** or currency union
 - **Currency board**
 - **Peg**

Fixed

Horizontal bands

- **Crawling peg**

Without bands

With bands

- **Floating**

Managed

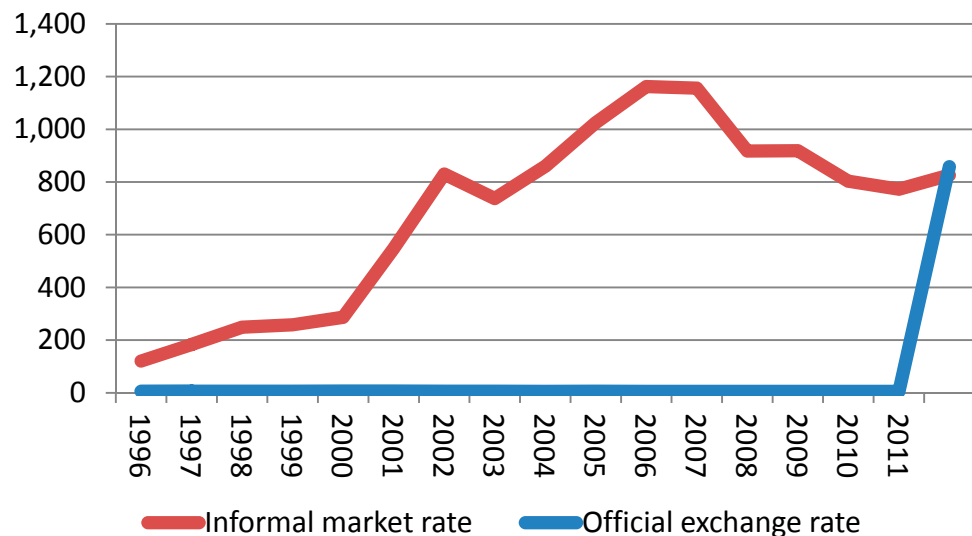
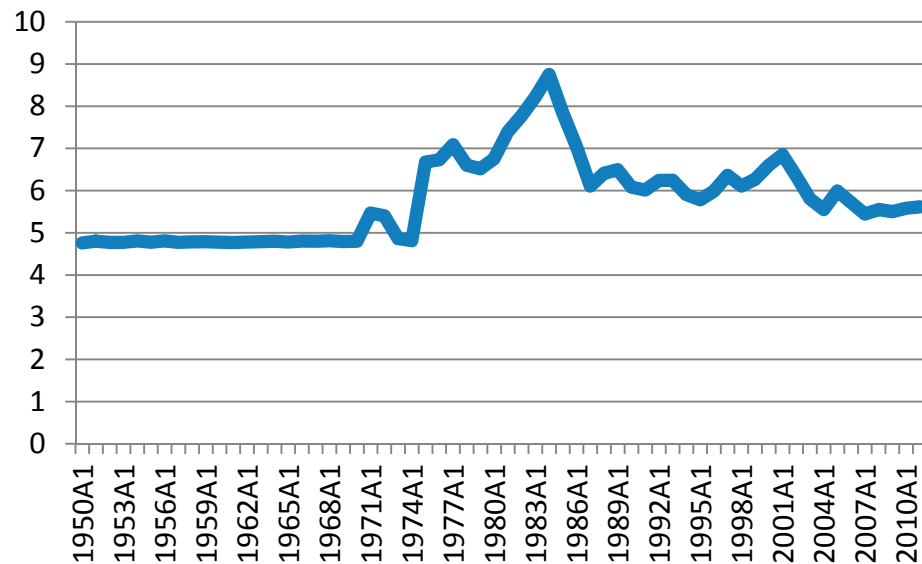
Independent

FIXED

FLEXIBLE

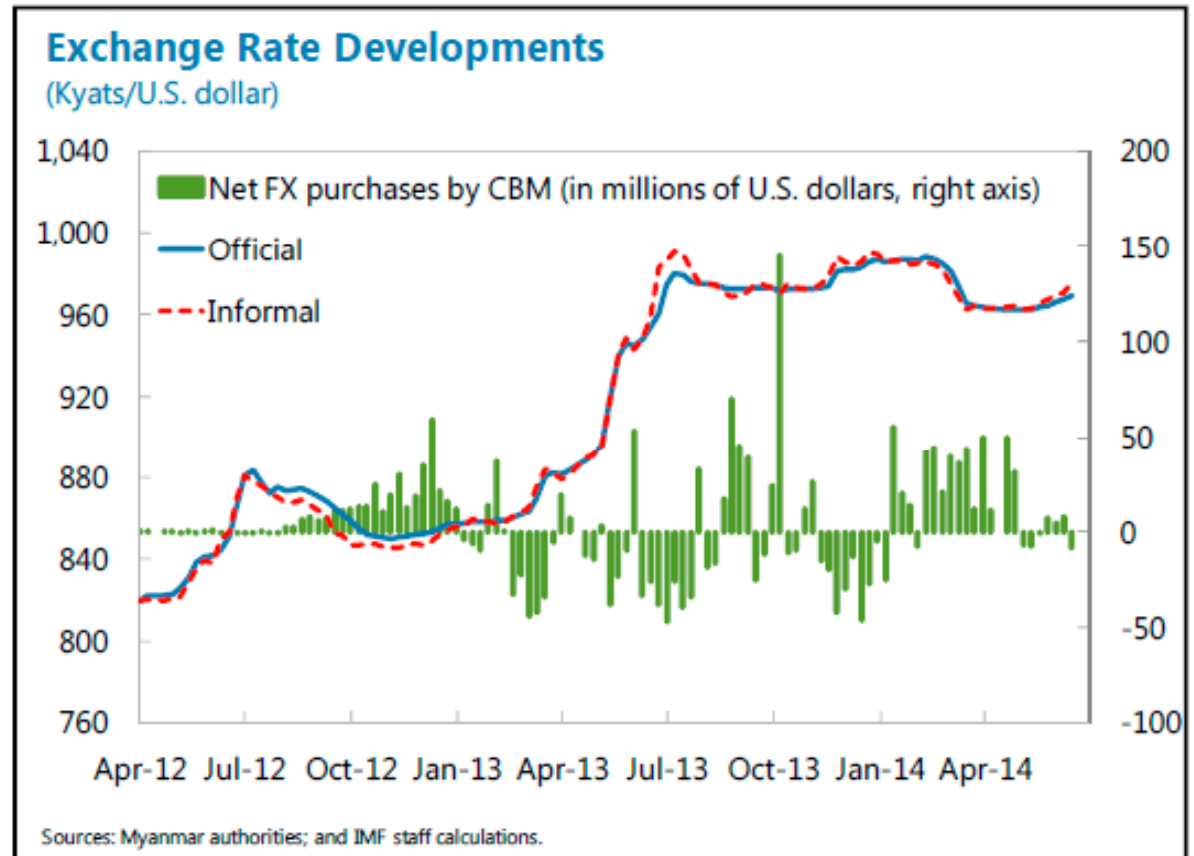
Exchange Rate Regime in Myanmar: Historical Perspective

- Official rate was very stable between 1950 and 2011— but it was set by government with no relationship to economic developments
- In 2012, official rate was allowed to float and brought in line with market rate

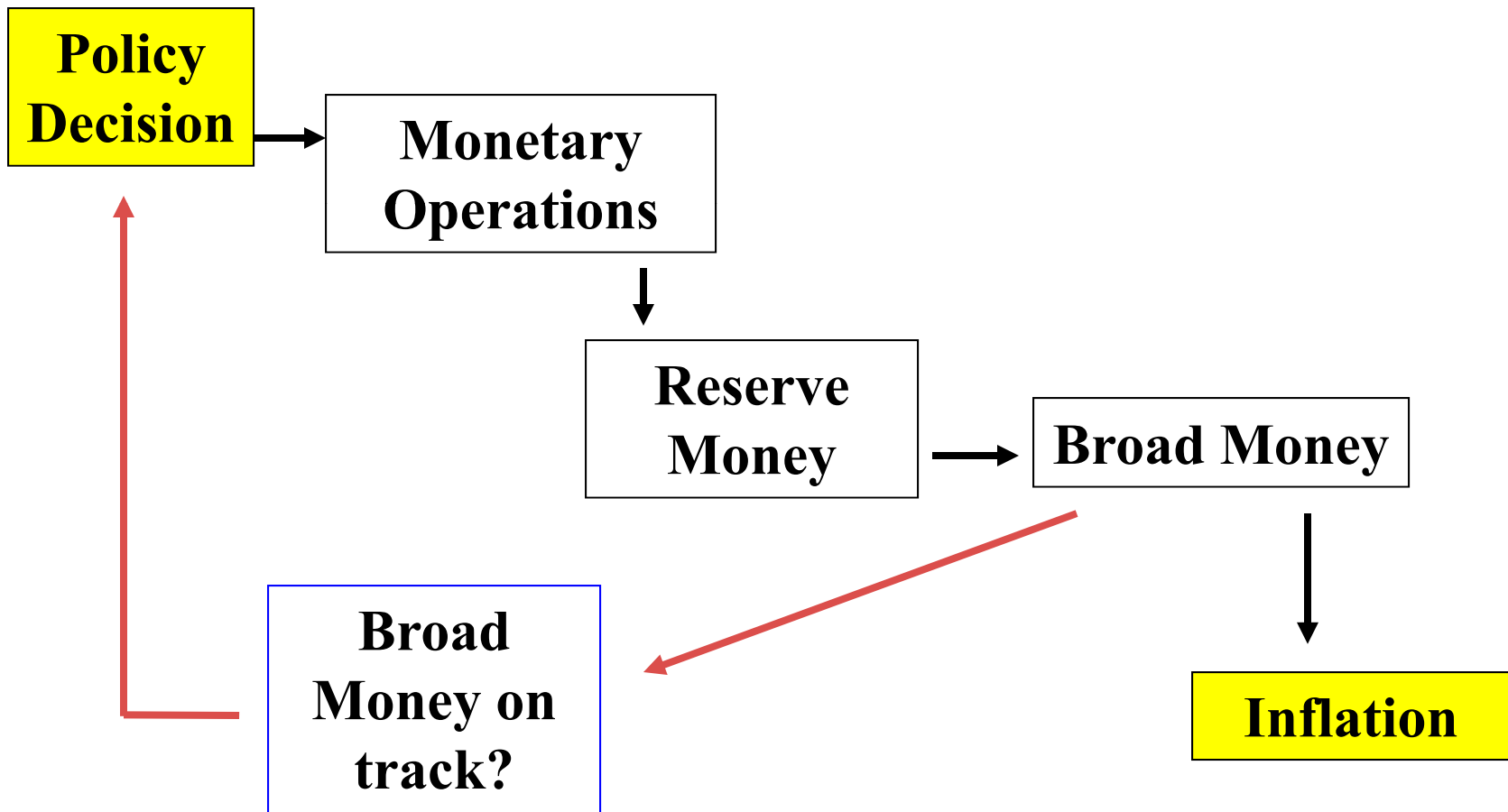


Exchange Rate Regime Myanmar: 2013

- April 2012: CBM started daily foreign currency auctions to determine exchange rate
- **De jure:** effective April 2, 2012, the de jure exchange rate arrangement was reclassified to a **managed float** from a conventional peg
- **De facto:** due to multiple exchange rates, de facto regime is classified as **other managed arrangement**

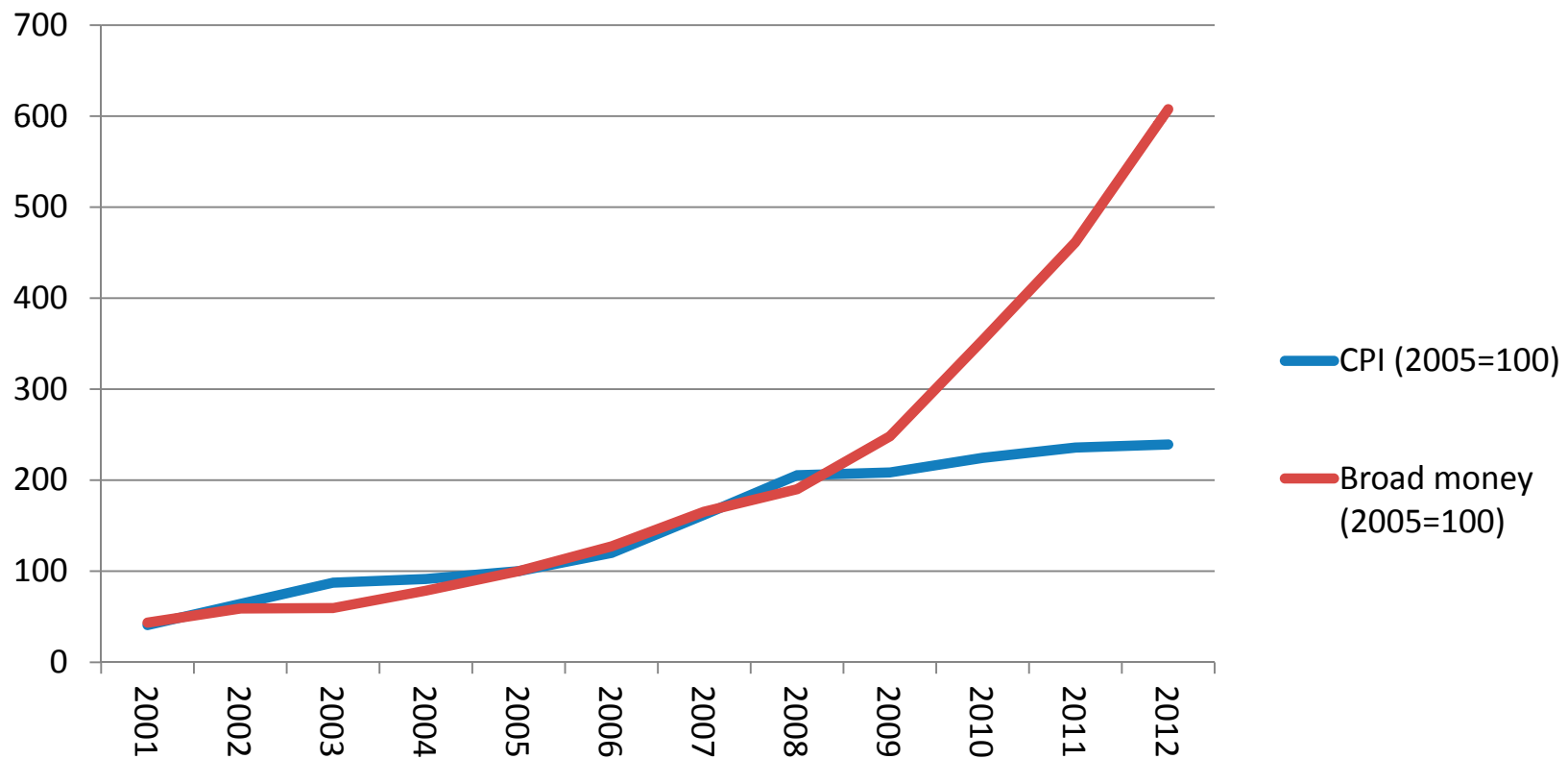


Monetary Targeting Regime



Monetary Framework in Myanmar

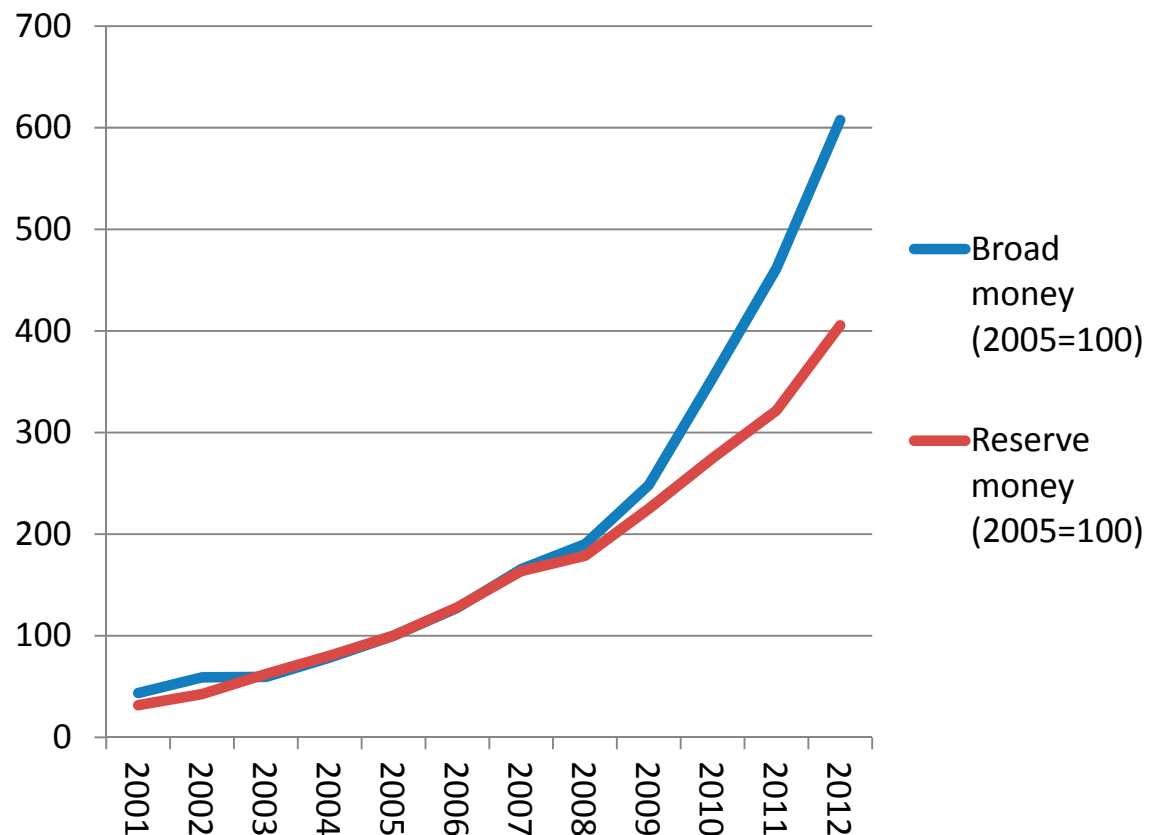
Historically close link between broad money and prices:



Monetary Framework in Myanmar

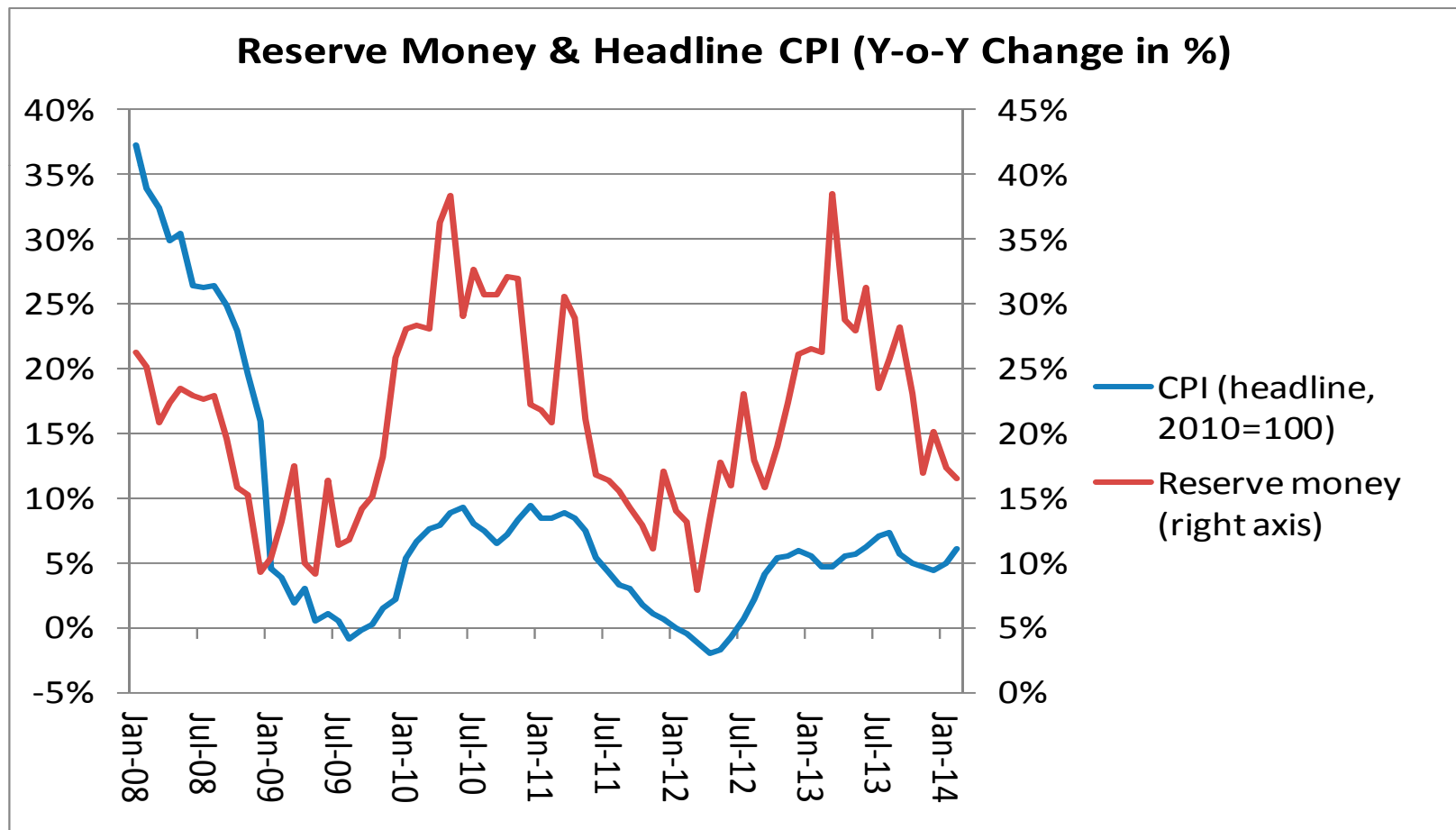
Historically, reserve money and broad money are also closely linked:

This opens possibility for central bank to influence prices via its control over reserve money and the broad money-price linkage



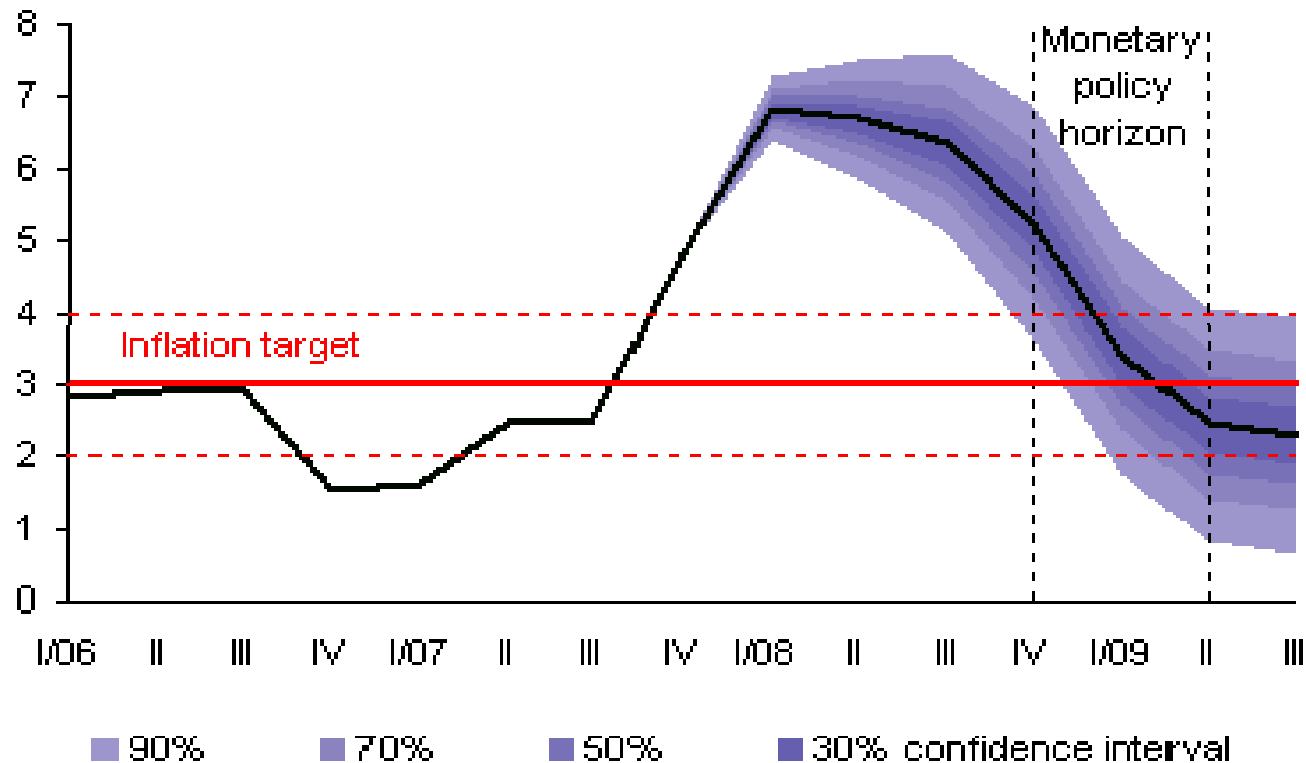
Monetary Framework in Myanmar

More recently, there is still a close link between reserve money growth and inflation:



Inflation Targeting Regime

Make a convincing case that inflation *forecast* is on track



Thank You!

In the next lecture, you are going to hear more about reserve money and the CBM balance sheet.