



# Monetary Policy Frameworks

**Financial Programming and Policies**  
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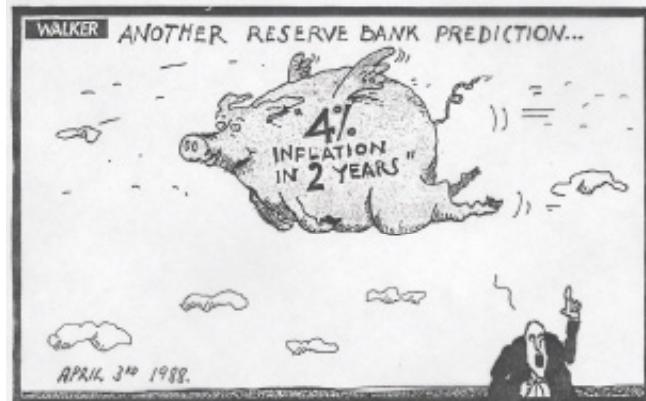
## Outline

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

# Central Bank Objectives: Inflation

## Keeping inflation under control



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

*Don Brash, former RBNZ Governor*

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# 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



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## Central Bank Objectives: Financial System Stability

Keeping the banking system solvent!

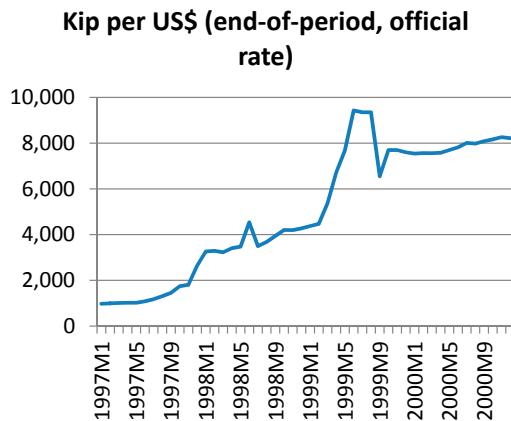
Well-functioning credit and payment system



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## Central Bank Objectives: Historical Experience in Lao PDR

15 Years Ago, Lao PDR struggled with all three objectives:



“... vicious inflation-depreciation circle emerged” (IMF 2000)

“... emerging signs that most banks, including all state commercial banks (SCBs), are insolvent” (IMF 1998)

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# Central Bank Objectives: Lao PDR Today

## Objectives of Bank of Lao P.D.R. (2012)

General objective (BoL law): maintaining stability of the kip

→ Internal stability: price stability

→ External stability: foreign exchange stability

Plus: financial stability mandate

Specific objectives:

- Keeping inflation rate below real GDP growth rate
- Keeping M2 growth rate below 25%
- Limiting exchange rate volatility vis-à-vis the U.S. dollar and the Thai baht within +/- 5 percent band each year

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# 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

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# Outline

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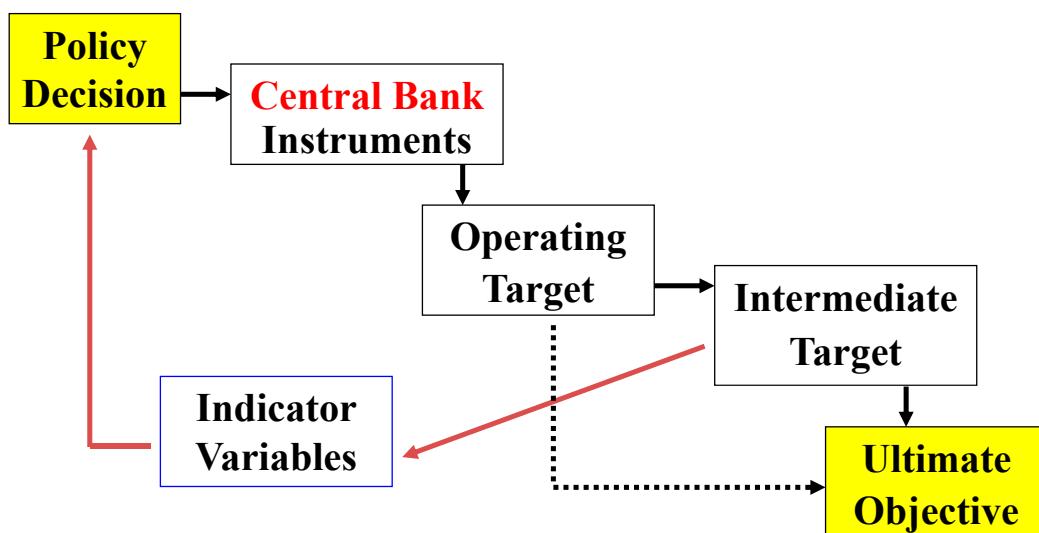
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# Monetary Policy Frameworks

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



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# 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



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## 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.)



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# 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



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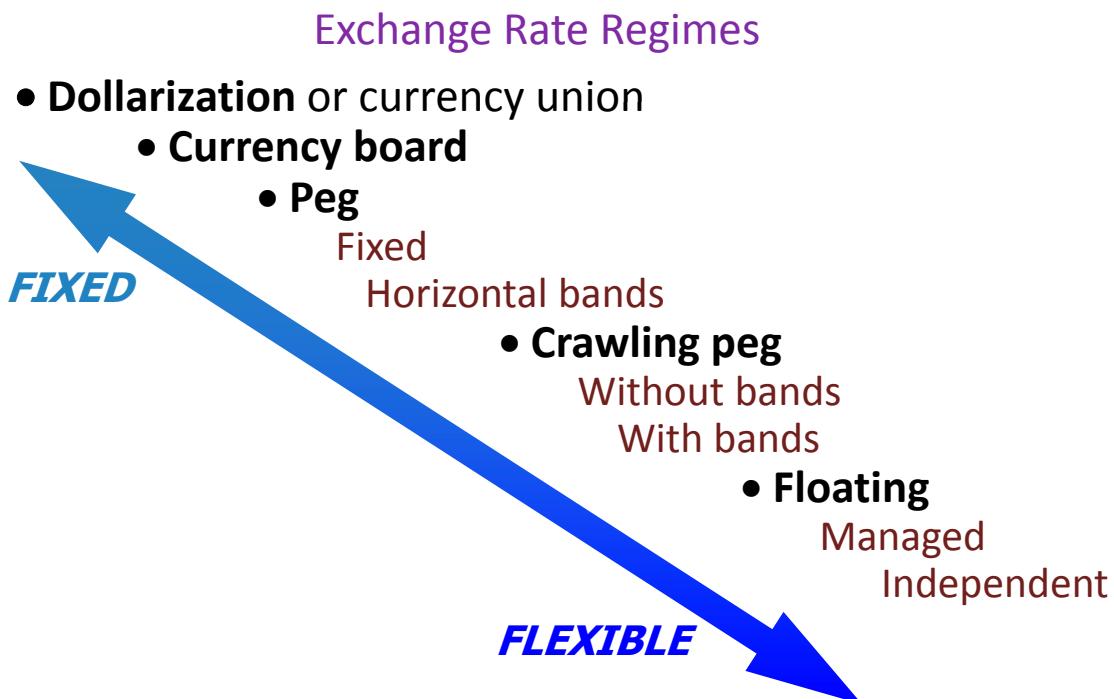
## Intermediate Targets as Nominal Anchor

- 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



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# Classification of Monetary Frameworks



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## Exchange Rate Regime in Lao PDR

What is the exchange rate regime of Lao P.D.R.?

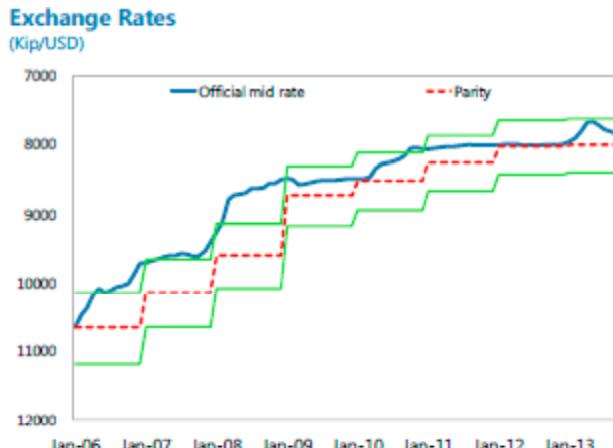
- Start by taking a look at the IMF 2013 Article IV report, Informational Annex, p. 3 ...
- See also Annual Report on Exchange Arrangements and Exchange Restrictions (AREAR)



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# Exchange Rate Regimes in Lao PDR

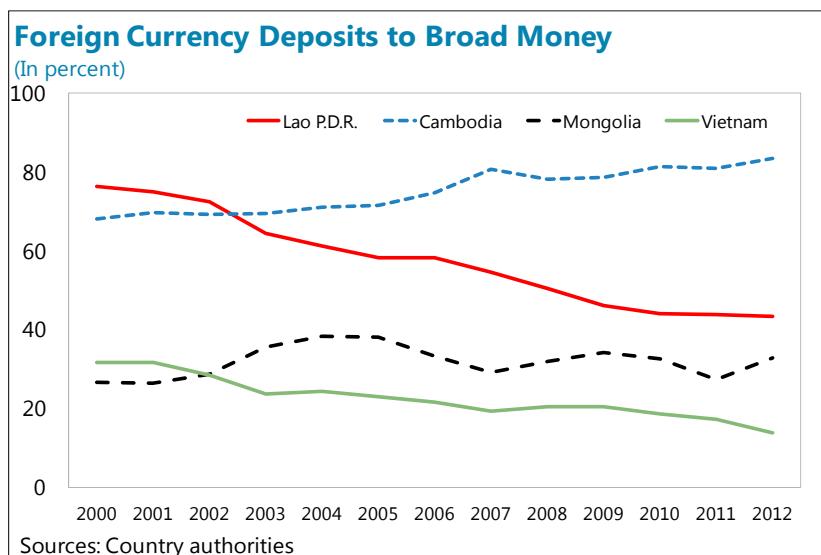
- De jure: floating  
(Definition: A floating exchange rate is largely market determined, without an ascertainable or predictable path)
- ▶ 2012 classification: stabilized  
(Definition: ... entails a spot market exchange rate that remains within a margin of 2% for six months)
- ▶ 2013 classification: crawl-like  
(Definition: ... exchange rate must remain within a narrow margin of 2% relative to a statistically identified trend for six months)



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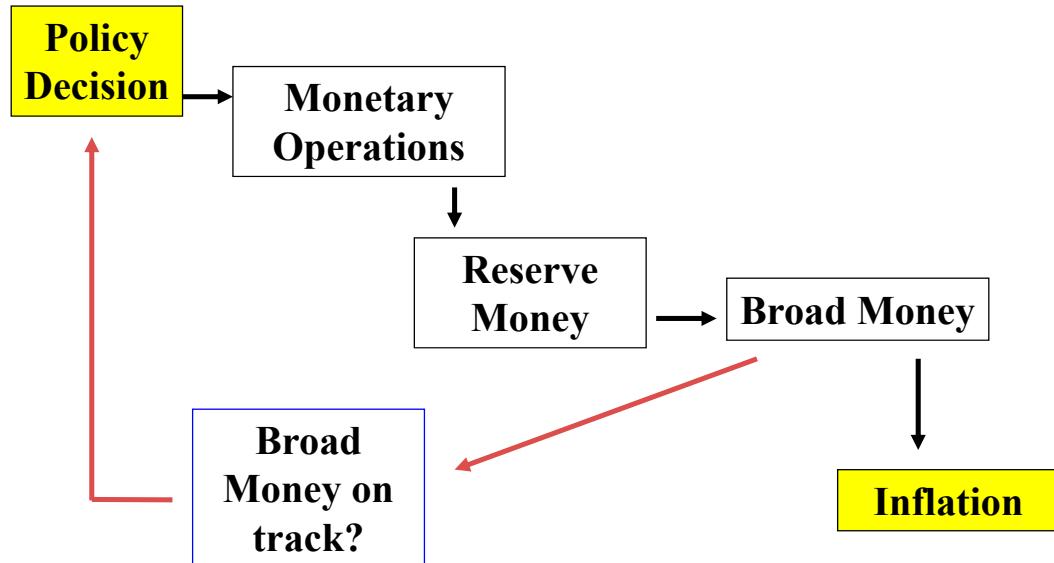
# Exchange Rate Regimes in Lao PDR

Dollarization Has Receded



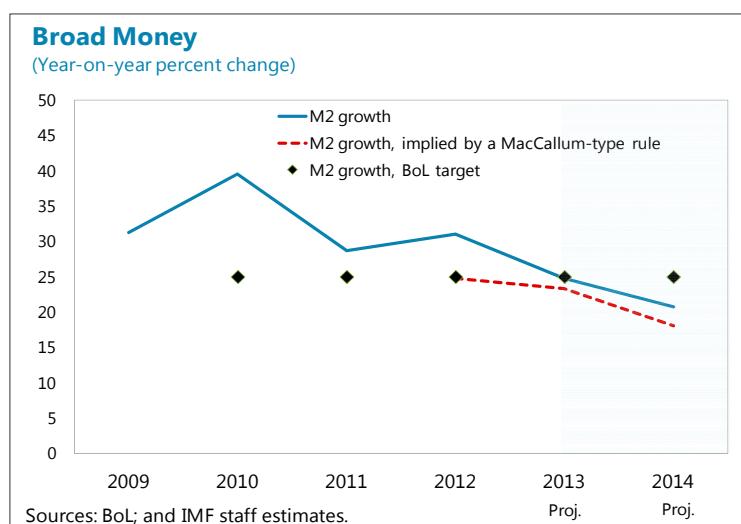
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# Monetary Targeting Regime



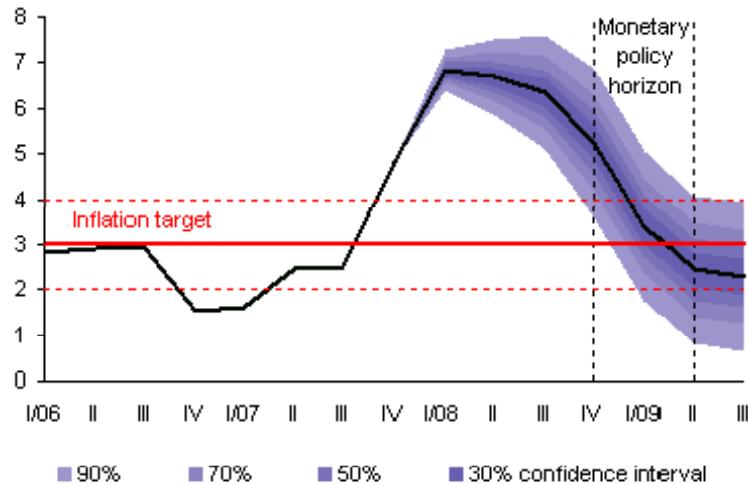
## Monetary Targeting in Lao PDR

BoL's Objective to Keep M2 Growth Below 25%



# Inflation Targeting Regime

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



Thank You!

In the next monetary lecture, we are going to take a closer look at the link between reserve and broad money—to do so, we have to look into the monetary accounts ...