



Introduction to Monetary Policy

Workshop for Staff of
Ministry of National Planning and Economic
Development
Nay Pyi Taw, Myanmar
June 2 – 3, 2014

Jan Gottschalk
TAOLAM

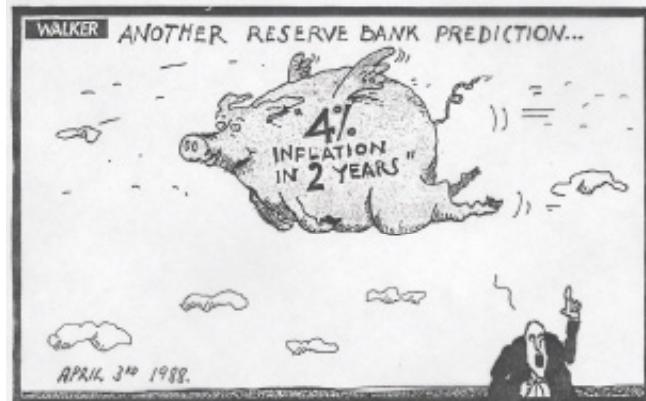
IMF-TAOLAM training activities are supported by funding of the Government of Japan

Outline

- 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

3

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



4

Central Bank Objectives: Financial System Stability

Keeping the banking system solvent!

Well-functioning credit and payment system



5

Central Bank Objectives & Functions

Monetary Stability

- Monetary policy
- Exchange rate policy

Financial stability

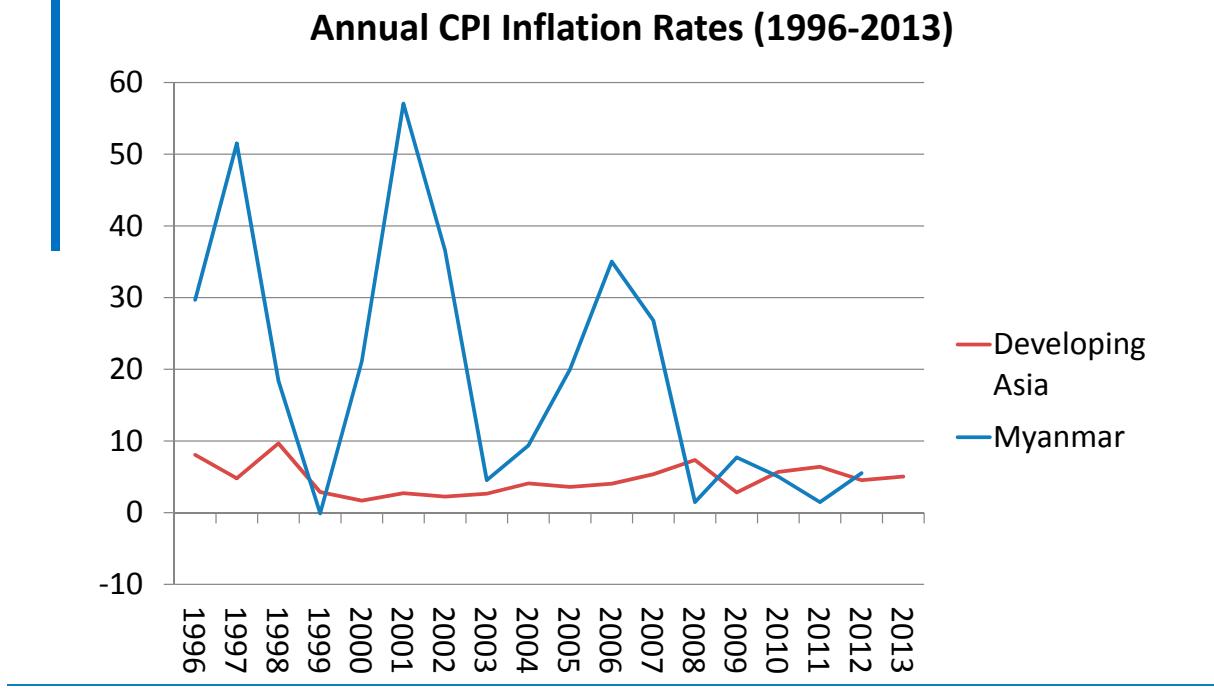
- Prudential policy
- Supervision, oversight

Policy Operation Functions

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

6

Central Bank Objectives: Historical Experience in Myanmar



7

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

8

Outline

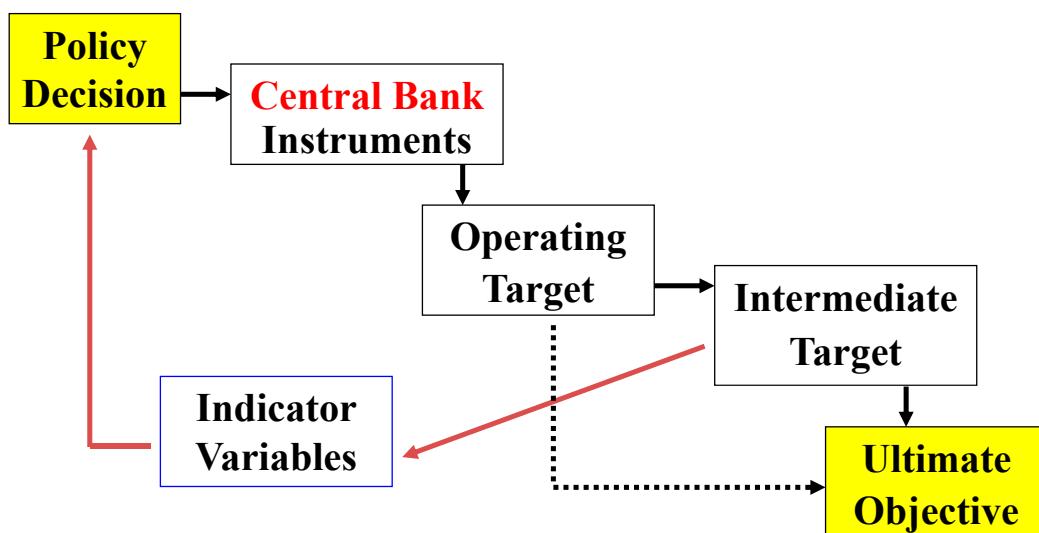
I. Central Bank Objectives

II. Monetary Policy Frameworks

9

Monetary Policy Frameworks

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



10

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



11

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.)



12

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



13

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



14

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

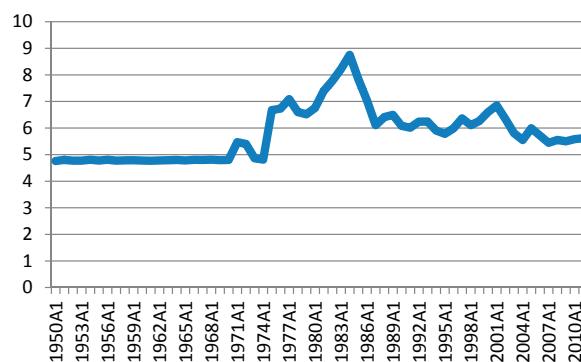
FIXED

FLEXIBLE

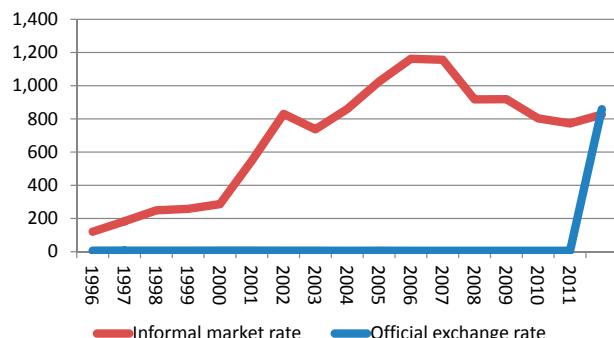
15

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

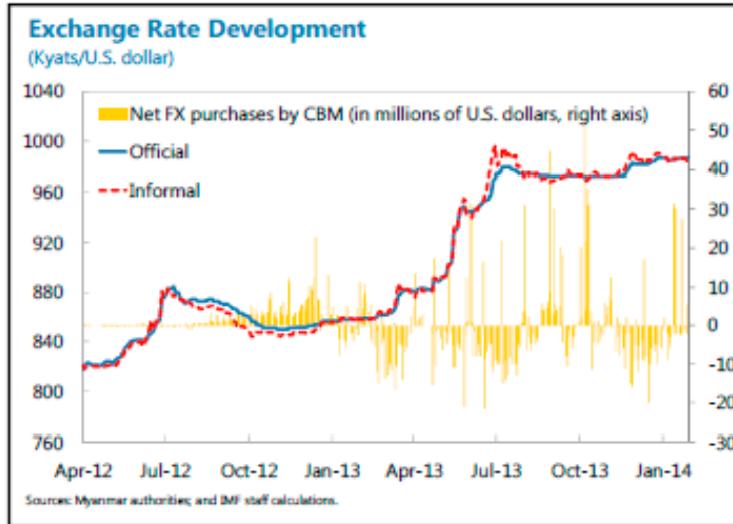


- In 2012, official rate was allowed to float and brought in line with market rate



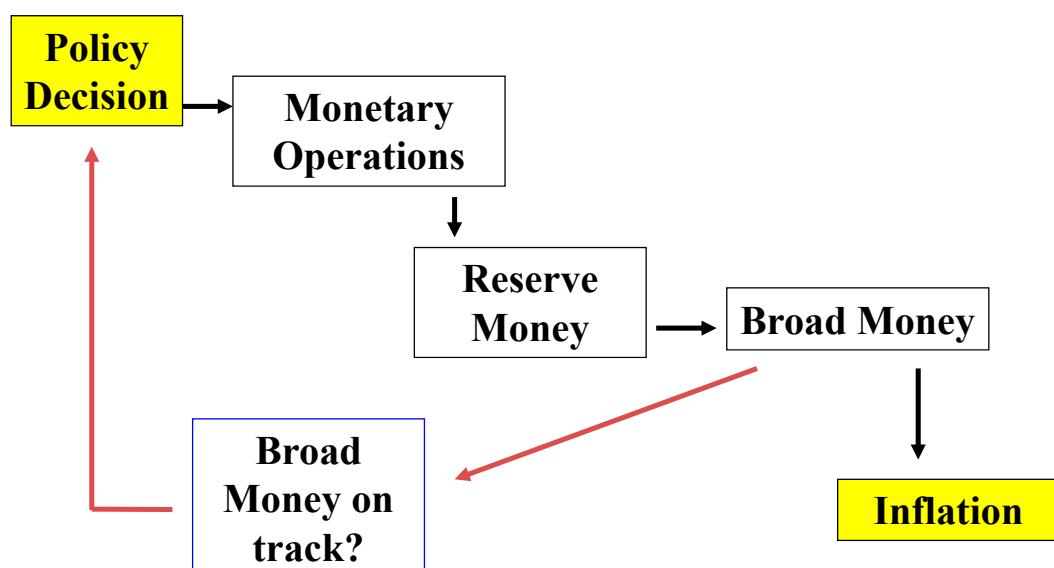
Exchange Rate Regime Myanmar: 2013

- 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**



17

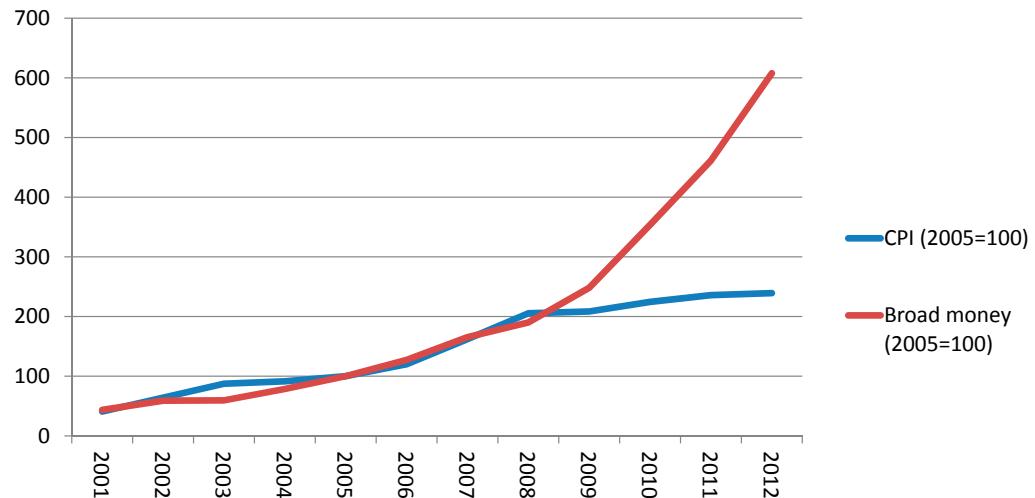
Monetary Targeting Regime



18

Monetary Framework in Myanmar

Historically close link between broad money and prices:

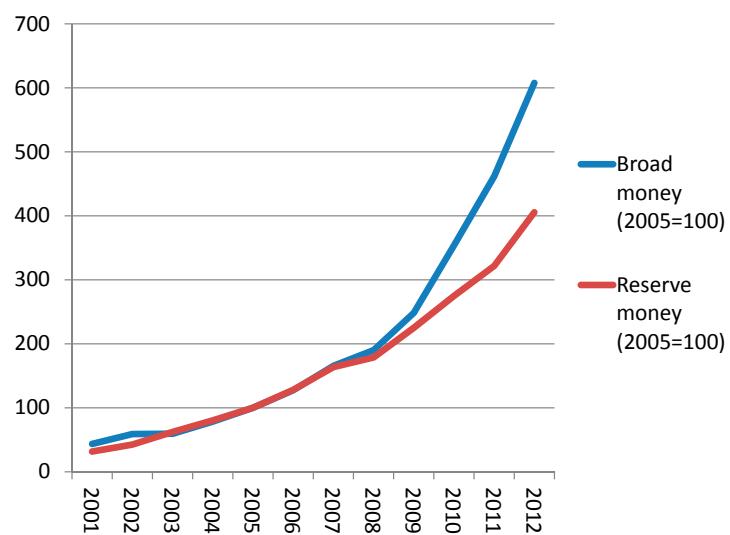


19

Monetary Framework in Myanmar

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

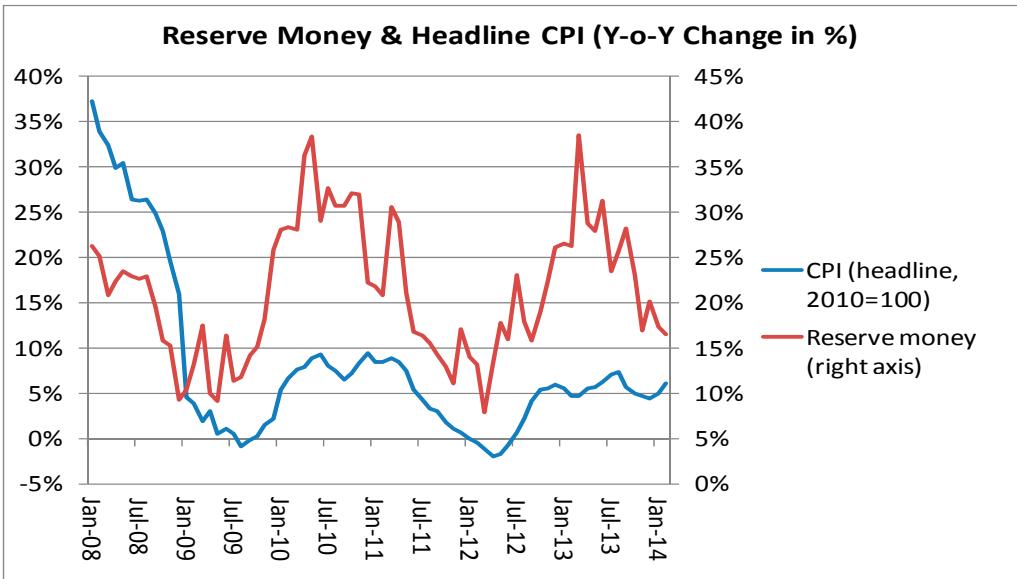
This opens possibility for central bank to influence prices via its control over reserve money and the broad money-price linkage



20

Monetary Framework in Myanmar

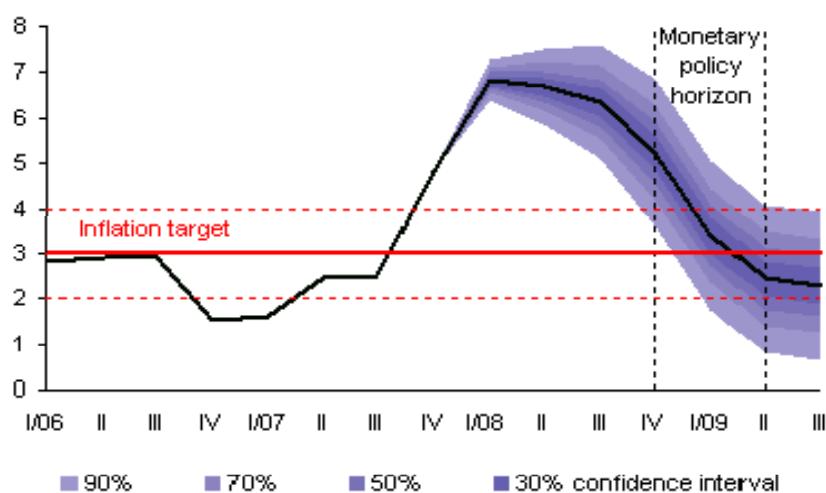
More recently, there is still a close link between reserve money growth and inflation:



21

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 the interrelationships between the different sectors.