

Analyzing the Monetary Sector

Overview

Jan Gottschalk
TAOLAM

This training material is the property of the IMF – Singapore Regional Training Institute (STI) and is intended for the use in STI courses. Any reuse requires the permission of the STI.



Central Bank of Myanmar - TAOLAM
“Introduction to Financial Programming”
December 16-20, 2013 Yangon, Myanmar



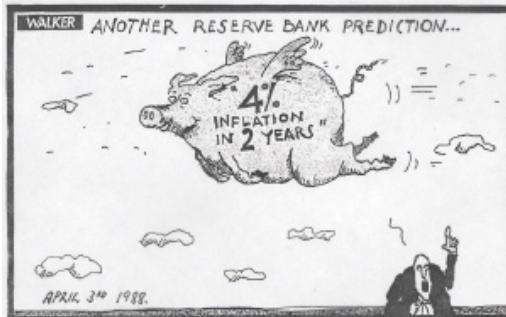
Overview

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



I. Central Bank Objectives

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



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





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

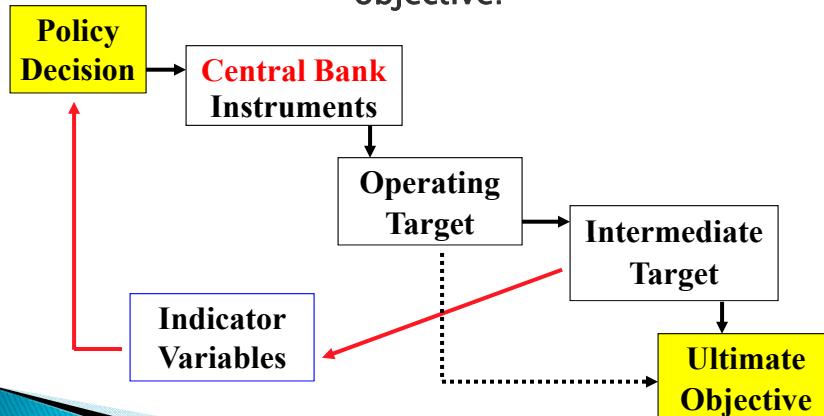
Policy Operation
Functions

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



II. 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 Target 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

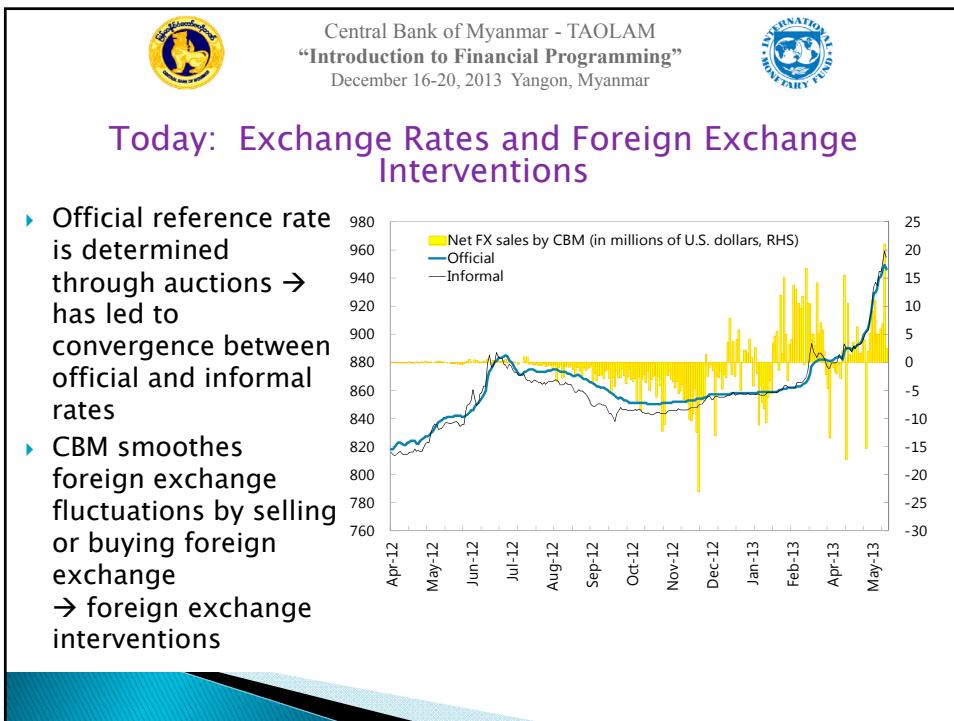
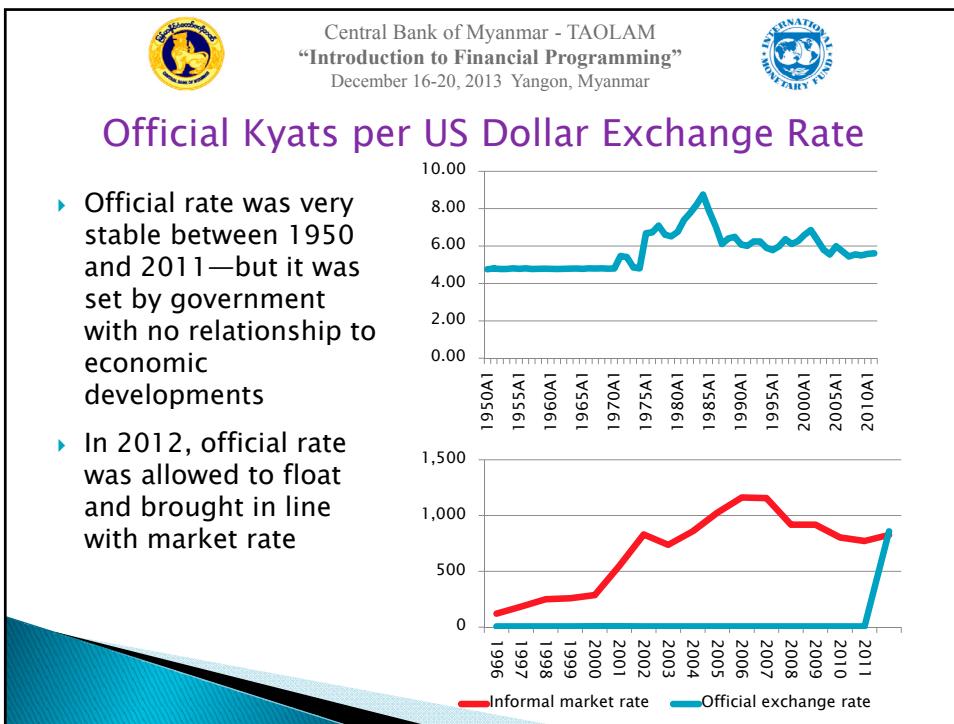
Exchange Rate Regimes

- Dollarization or currency union
 - Currency board
 - Peg

FIXED

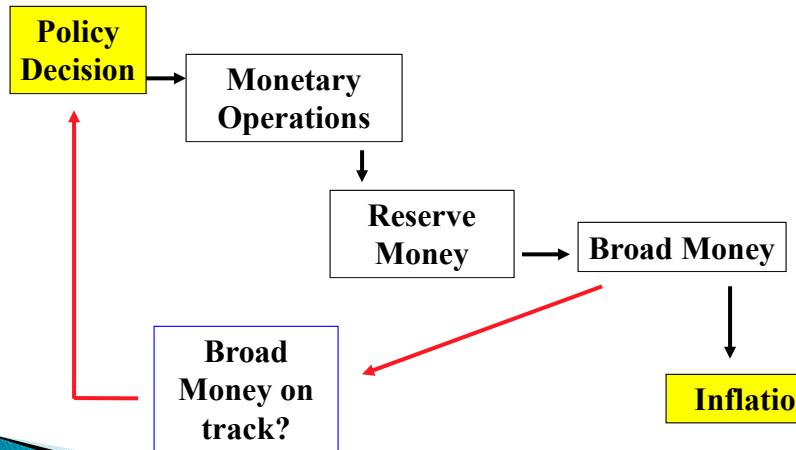
Flexible

- Crawling peg
 - Without bands
 - With bands
- Floating
 - Managed
 - Independent



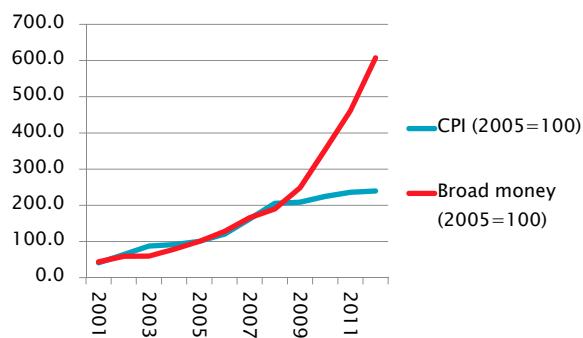


Monetary Targeting Regime



Monetary Targeting Regime (cont.)

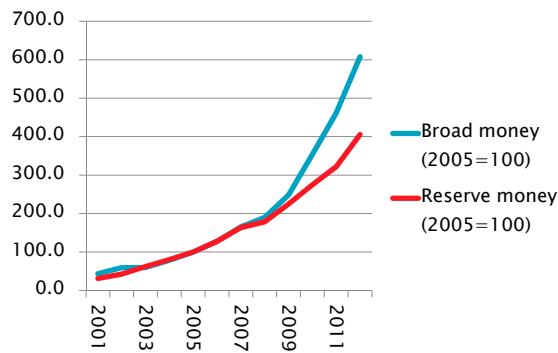
Relationship between broad money & CPI:





Monetary Targeting Regime (cont.)

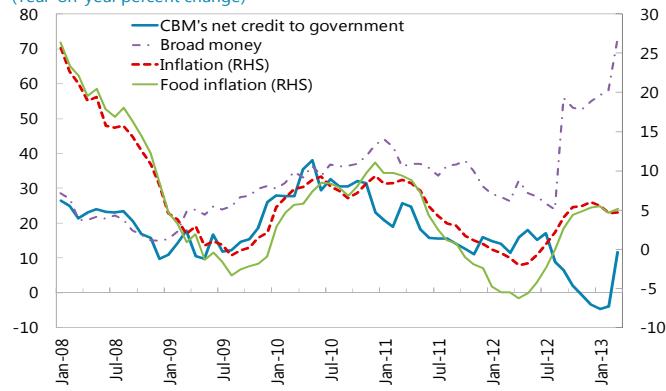
Relationship between reserve money & broad money:



Monetary Targeting Regime (cont.)

Relationship between money growth & inflation:

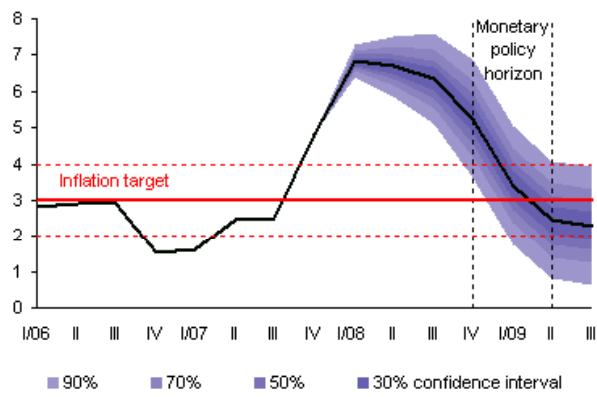
Monetary Aggregates and Inflation (Year-on-year percent change)





Inflation Targeting Regime

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



Thank You!

Next, 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 ...