

# Analyzing the Monetary Sector

## Overview

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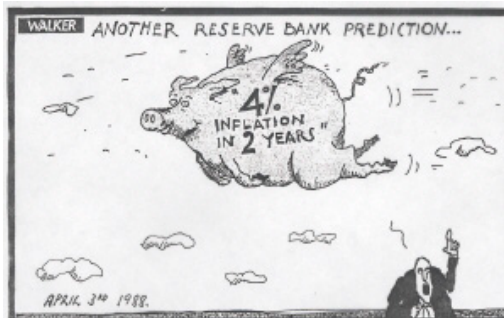
## Overview

- 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

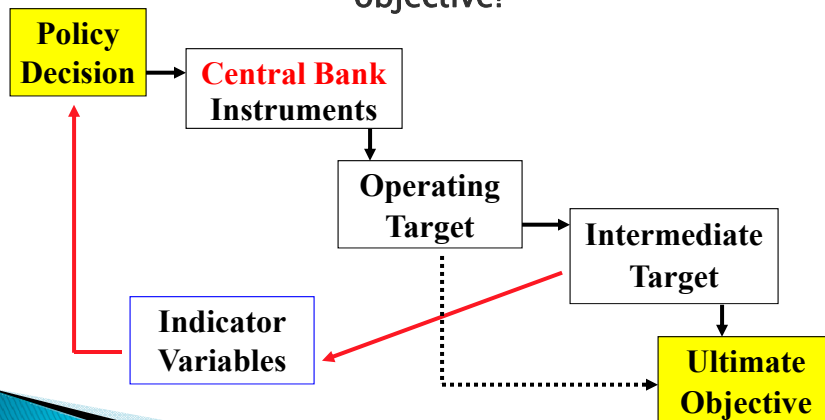
### Policy Operation Functions

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

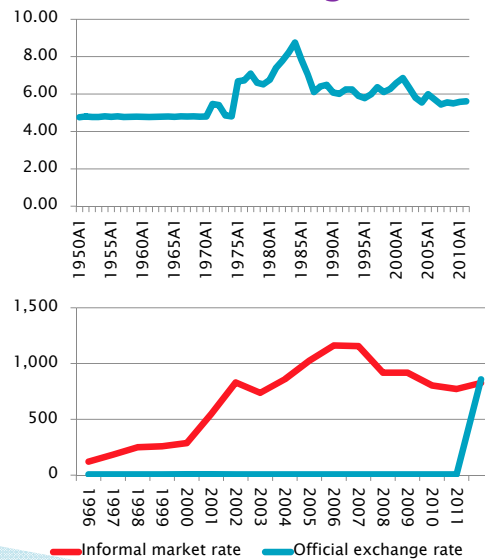
**FIXED**

**FLEXIBLE**



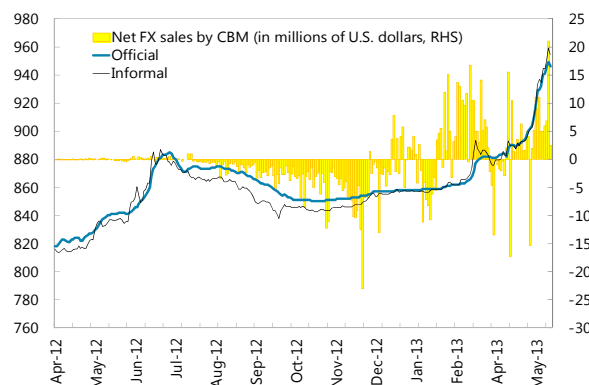
## Official Kyats per US Dollar Exchange Rate

- ▶ 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



## Today: Exchange Rates and Foreign Exchange Interventions

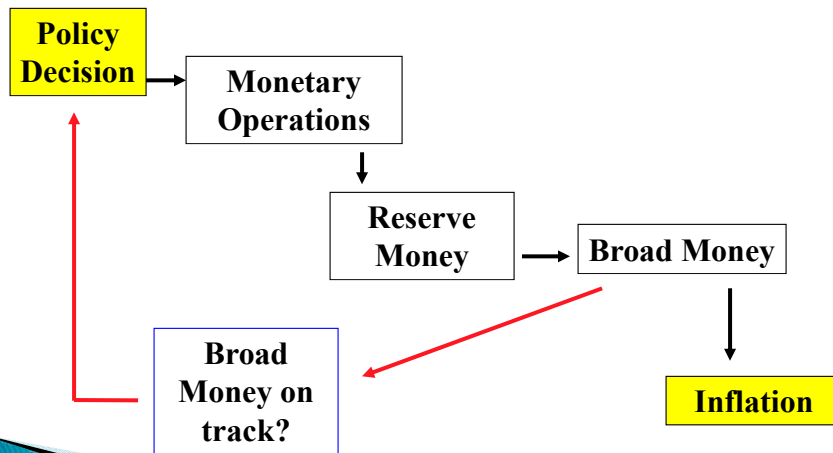
- ▶ Official reference rate is determined through auctions → has led to convergence between official and informal rates
- ▶ CBM smoothes foreign exchange fluctuations by selling or buying foreign exchange → foreign exchange interventions





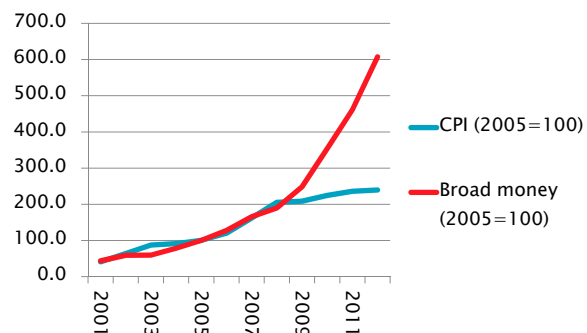


## Monetary Targeting Regime



## Monetary Targeting Regime (cont.)

### Relationship between broad money & CPI:

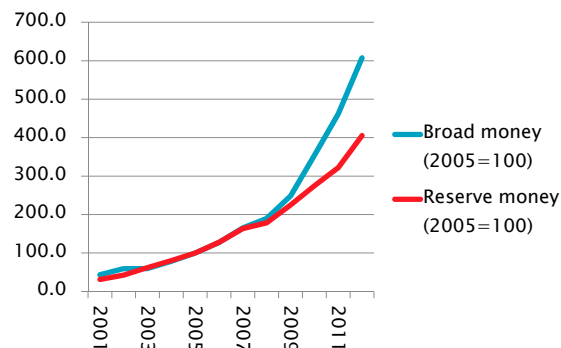






## Monetary Targeting Regime (cont.)

Relationship between reserve money & broad money:

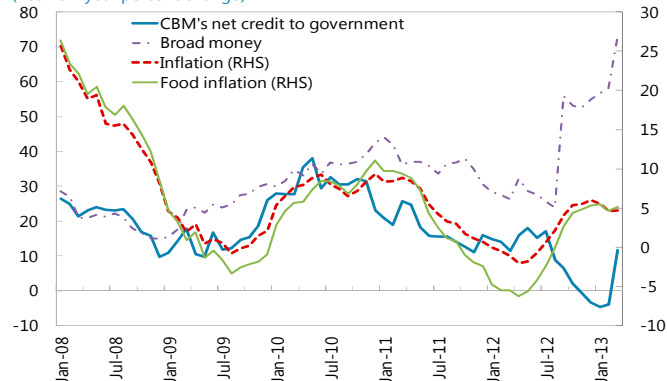


## Monetary Targeting Regime (cont.)

Relationship between money growth & inflation:

### Monetary Aggregates and Inflation

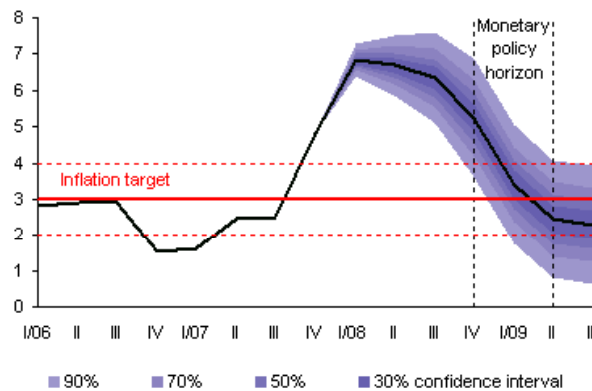
(Year-on-year percent change)





## 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 ...