

Discussion on
“Monetary Policy in a Globalised
and Uncertain World: Risks and Challenges”

*By Dr. Claes Berg
Advisor to the Governor, Sveriges Riksbank*

Dr. Duangmanee Vongpradhip
Assistant Governor, Monetary Policy Group, Bank of Thailand
*BOT International Symposium
7th November 2008, Bangkok*

Conclusion on the presentation

- Comprehensive presentation on how “modern” central banks conduct monetary policy in a globalized environment
- Discussions on new approaches to assessing optimal reserves, given effects of *globalisation* and recent global financial crisis
- Introduction of concept of foreign exchange reserves as an insurance policy for financial stability and monetary policy objectives
- Discussions on transparency and accountability

... On globalisation and monetary policy

- *The presentation poses the question: “can monetary policy control inflation in a globalised world?” and discusses how globalisation has changed the transmission mechanism*

Remaining Challenges

- Recent inflationary episode was a consequence of *globalisation*
- The issue resolved somewhat with the global downturn
- However, repeating incidence could resurface and monetary policy coordination could be called for going forward.

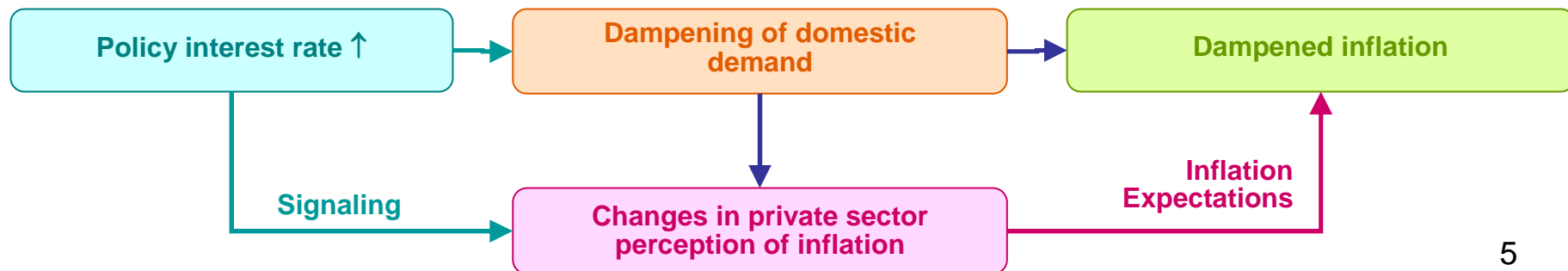
... On the role of the exchange rate

- *The paper notes that “the exchange rate will appreciate as a result of an increase in the relative tightness of domestic monetary policy...”*
- The causality of monetary policy on the exchange rate may not be so straightforward:
 - Monetary policy and the exchange rate reflect long-term economic fundamentals
 - Numerous circumstances can also affect exchange rate movements
- Exchange rate may also play additional role in curbing inflation, especially in the case of temporary supply shocks.

... On the importance of the expectations channel

- *“the globalisation of best practice monetary policy frameworks has probably strengthened the expectations channel”*
- Managing expectations could increase monetary policy effectiveness with less negative impact on the real economy.
 - Especially when tightening stance is perceived as a sign of credibility and commitment in restraining inflation

The pass-through of policy interest rates to inflation



... Consequences of Reserve Management: *Paper Summary*

- Global financial crisis has implications on reserve management
- FX reserves are required for both *monetary policy objectives and financial stability objectives*.
- Particular objectives for holding reserves include:
 - For interventions;
 - Maintain confidence in the functioning of FX markets;
 - Providing liquidity to financial institutions.
- Central banks may incorporate swap (credit) lines in calculating their reserve needs

... Consequences of Reserve Management: *Paper Summary (cont.)*

- Two models are suggested for optimal level of reserves by using contingent claims analysis (CCA)
- The Gray and Maechler Model (2008):
 - Focuses on *financial stability objective*
 - Uses banking sector data and contingent claims analysis to estimate the FX reserves required in different scenarios
- The Lee Model (2008):
 - Focuses on both *monetary policy and financial stability objectives*
 - Includes the role of external insurance (swap lines, which are determined endogenously) in supporting the central FX reserves

... Thoughts on the model

- The paper is **innovative in providing an alternative framework** for calculating the optimal level of reserves
- However, for EME's , there are some considerations:
 - 1) **The model assumes that EME's have sufficient and timely access to swap lines:**
 - Swap lines likely to work only in times of liquidity shortages
 - In practice, notional amounts are relatively small
 - Regional swap lines may fail should a systemic shock affect the region as a whole

... Thoughts on the model (cont.)

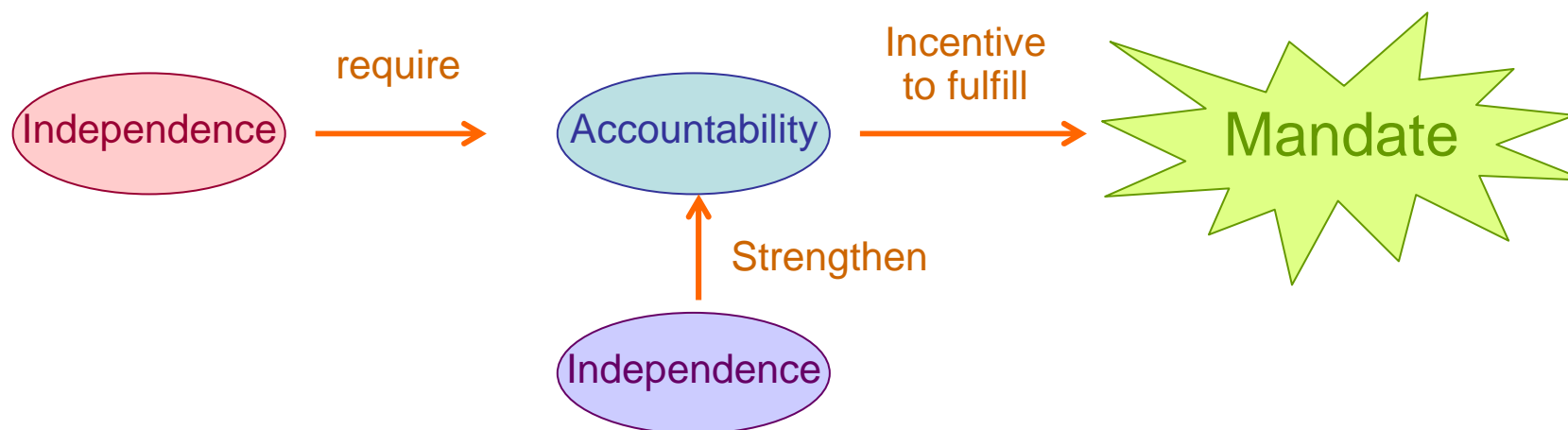
- 2) The model may be difficult to apply:
 - Difficult to estimate **D** (the central bank's total need for financial assets in an emergency situation) for EMEs
 - If **D** covers only the banking system, there could be risk of underestimating coverage
 - But including *all* potential aspects for coverage (monetary policy and financial stability) in **D** may be difficult
- 3) Using FX reserves as an “insurance policy” can lead to moral hazard problems

... On interest rate forecasts

- The Bank of Thailand considers interest rate forecasts in its internal policy discussions based on interest rates implied by financial markets
- No current practice of publishing a “preferred interest rate path” due to:
 - concerns on incorrect interpretation on the forecast path
 - concerns that the market will take the forecast as a “promise”

... On transparency and accountability

- The presentation points out the relationship between transparency and independence



- Central bankers also recognized that increased transparency helps to allow better functioning in financial markets
- Monetary policy transparency in many cases unilaterally adopted by central banks despite legal requirements