

Guru Speak : BOT MEETING NOTES FIRMS ARE RELYING LESS ON POLICY RATE

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Last week the Bank of Thailand's ninth annual economic symposium, entitled Monetary Policy in a Volatile World: Challenges and Strategies Going Forward, left food for thought for participants and homework for BOT economists.

This year the focus of BOT research included Thailand's potential output, the dynamics of inflation, the potential role of exchange-rate management in looking after price stability, and the impact of globalisation on monetary-policy effectiveness.

The symposium underscored the important role of expectations in contributing to the effectiveness of monetary-policy transmission. As exemplified by the US experience, research pointed to the prospect that as Thai financial markets become more developed, deeper and broader, the direct impact of the central bank's changes in policy rate would be reduced. On the one hand, financial-market development leads to a better pass-through of policy interest rate into financial market rates.

On the other hand, greater financial-market development and globalisation of financial markets have made longer-term rates more responsive to external developments and decoupled them from the short-term rates that policy can influence. In fact, one of the panellists, Supavud Saicheua, emphasised that financial innovation had also reduced private firms' reliance on the policy rate as a benchmark for their borrowing costs.

Since the effectiveness of monetary policy cannot be illustrated by short-term growth performance, policymakers should take a longer-term view of enhancing the economy's growth potential through productive investment and productivity improvements, rather than just short-term growth gains. In this regard, central bank credibility is a critical determinant of policy success.

Indeed, independence can usefully augment the central bank's credibility. As BOT Deputy Governor Bandid Nijathaworn elaborated during the panel discussion, independence does not mean the freedom to do anything the central bank likes; rather it means the ability of the central bank to make appropriate policy decisions and employ appropriate instruments of

appropriate magnitude to fulfil the central bank's mandate without the constraint of political cycles.

As the choice of monetary-policy target and the flexibility of the monetary policy-making process should take into account changing external and financial environments, additional developments that may add to the complications of monetary-policy formulation are food and fuel prices, the dynamics of inflation and asset prices. Food and fuel prices, though cost-push factors, need not be temporary, especially when they change as a result of structural shifts in supply and or demand.

The dynamics of inflation have also exhibited higher persistence of inflation, especially in the case of structural changes.

In the meantime, asset prices may not move in line with the overall economic cycle, making it possible for monetary policy to produce an unintended impact on asset-price developments. The latter is an area where macro-prudential policies may produce more effective outcomes than the interest-rate policy per se.

Symposium participants agreed that more research was needed to back up the decision-making process of monetary policy until they met again at the BOT economic symposium next year.

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