

## **IT'S TIME FOR CENTRAL BANKS TO REMOVE THE PUNCH BOWL**

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DURING the last two weeks, an increasing number of Asian central banks, including the Bank of Thailand, have joined their front-runner counterparts, Malaysia and India, in the monetary policy normalisation process. The main reason to start raising the policy rate is robust economic expansion, which lowers the need for an exceptionally accommodative monetary policy stance.

Looking back, the global economic crisis that began in 2008 hit Asian economies severely, prompting central banks in the region to cut their policy rates to historically low levels. At this juncture, Asian economies have recovered relatively quickly, as illustrated by double-digit growth in the first quarter of this year, leading global GDP back to the pre-crisis level.

Large stimuli, buoyant export demand and improving confidence have allowed Asian economies to record such extraordinary economic performance. High-frequency economic indicators as well as recent releases of preliminary second-quarter GDP data of Singapore and China also suggest that economic activity has fully recovered and remained vigorous, despite some renewed tensions in the global financial markets due to the European sovereign debt crises.

Such economic performance has prompted economists to revise Asian GDP upward for the short-term periods ahead. The International Monetary Fund (IMF), in its latest World Economic Outlook report, raised developing Asia GDP forecasts for 2010 by 0.5 per cent to 9.2 per cent.

While downside risks have risen somewhat following the concern about public debt in the euro zone, Asia's limited linkages and strong intra-region demand will partly mitigate the impact and provide a cushion for further economic growth.

Leaving the policy rate very low for too long could increase the cost for central banks of withdrawing liquidity from the system when inflation risk emerges. It could also adversely affect financial stability if too-low interest rates lead to asset price bubble formation.

Despite the rise of policy rates, the overall monetary policy stance in Asia is still accommodative. Current policy rates in the region are significantly below their historical averages.

Thus, it is unlikely that the rate hikes will undermine economic growth in the short term. Indeed, the normalisation of the policy stance helps to promote sustainable growth in the medium term, as it helps reduce risks of potential financial imbalances, as well as provides central banks with more policy space.

Removing the punch bowl before everyone has enjoyed the party is always a tough call but central banks cannot deny such responsibility. This job requires the right timing and speed. It is therefore crucial for central banks to effectively communicate to the public and clearly explain the reasons behind their policy moves.

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**(The views expressed are the author's own.)**

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