Monetary Authority of Singapore

BOT-IMF CONFERENCE, 1–2 NOVEMBER 2013

COMMENTS ON

INTERACTIONS BETWEEN MONETARY AND MACROPRUDENTIAL POLICIES IN AN INTERCONNECTED WORLD

by Edward Robinson*
Monetary Authority of Singapore

* The views expressed in this presentation should not be attributed to the Monetary Authority of Singapore.

Introduction

- The financial crisis has led to a rethinking of monetary policy and the role of central banks.

> "Following long periods of stability, a monetary policy consensus builds up and solidifies, only to be shaken when the next major event materializes. The global financial crisis is no exception. It has already shaken some of the conventional wisdom about what constitutes good monetary policy and is likely to lead to further revisions of the consensus that evolved after the great inflation of the seventies and more recently, during the great moderation."
>
> Alex Cukierman (2013)

- A key area of debate concerns the dynamic tension between traditional monetary policies and newly evolved macroprudential tools.
- The comprehensive survey by Stijn Claessens succinctly describes the emerging consensus and provides useful practical guidance for policy-makers.

Outline of Comments

My comments will focus on three areas, and they are aimed at providing a practitioner's take on some of the issues raised by Claessens.

- Key aspects of the new operating environment that central banks face in the post-GFC era.
- How central banks can adapt their *modus operandi* to meet the new challenges and maintain monetary policy autonomy.
- A practical perspective on securing price and financial stability in a small and open economy, gleaned from Singapore's experience.

The Pre-crisis Consensus

- The Great Moderation was an exceptional period, marked by benign financial liberalisation/globalisation and positive supply shocks.

- Independent central banks — operating under an inflation targeting regime and adhering to rules-based monetary policies — secured macroeconomic stability at both the national and global levels.
    - John Taylor (2013): the global outcome was near an internationally cooperative (Nash) equilibrium, or NICE.

- Policy-makers mistakenly thought that price stability and micro-prudential regulation were sufficient conditions for financial stability.

New Operating Environment

- Features of the new global financial order that became more apparent after the crisis:
    - High financial elasticity
    - A global financial cycle
    - Capital flow waves
    - Dominance of institutional investors

- These new financial realities rendered the standard macro/finance models inadequate, thus diluting the usefulness of policy prescriptions that flow from them.
    - Cross-border capital account transactions, and not current account flows, dominate the BOP.
    - The exchange rate takes on "asset-type" properties in small, open economies.
    - Flexible exchange rates cease to act as an effective shock absorber.

Central Bank Responses

- Need to enhance rules-based monetary policy frameworks.
  - Embrace a broader concept of macroeconomic stability to include a financial stability objective.
  - Flexible inflation targeting: lengthen policy horizons and/or aim for wider targets.
  - Use macroprudential levers to prevent financial cycle and asset market excesses.

- Assign monetary policy to price stability and macroprudential policy to financial stability.
  - Dichotomy not so clear-cut in financially open economies.
  - Macroprudential policies and/or CFM measures needed to preserve monetary policy autonomy.
  - These policies and measures are best considered as a permanent addition to the toolkits of central banks in small and open EMEs.

Singapore's Approach

- Characterised as "Monetary Policy Plus".
  - Recognises that internal balance is more than closing the gaps in $\left(\dot{P} - \dot{P}^*\right)$ and $\left(U - U^*\right)$.
  - Financial stability needed for overall macroeconomic stability.

- Some structural factors which suggest a "greater demand on macroprudential policies".
  - Openness to both trade (about 3X of GDP) and financial flows (100% of GDP)
  - Large financial sector (12% of GDP; ADM assets amounted to US$1,093.3bn in 2012)
  - Exchange rate-centred monetary policy and implications of the UIP condition
  - Property as an asset class.

Interactions Between Policies

- Exchange Rate Policy
  - Aim for price stability over the medium-term.
  - Exchange rate sometimes "not sufficient" for financial stability and has "collateral effects".
  - Concerns over feedback from prices of asset services (rentals and vehicle prices) to consumer prices.

- MacroPrud Policy
  - Address systemic financial stability issues.
  - Dampen excessive credit growth and leverage build-up.
  - Asset (property) price increases: measures like property transaction taxes can achieve both objectives of aggregate demand stabilisation and financial stability.

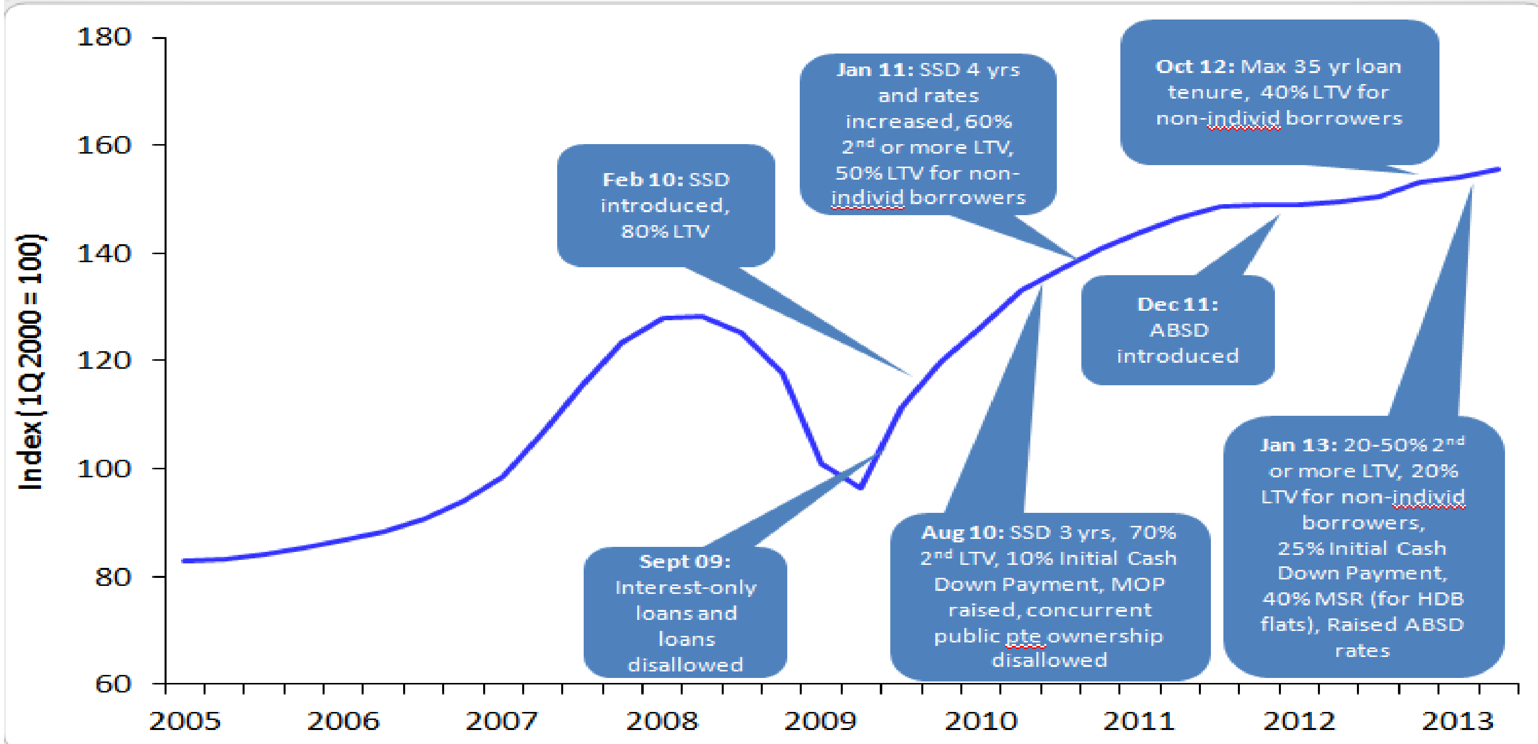
- Relation between MacroPrud and MicroPrud Policies
  - MicroPrud tools applied across institutions can help mitigate risk at the systemic level e.g. LTV and TDSR limits.

Accountability and Coordination Issues

- Accountability issues
  - MAS is responsible for design and implementation of both Monetary and MacroPrud policies.
  - Separate decision-making committees.
  - Overlapping membership to facilitate coordination and ensure overall consistency between policies.

- Coordination Issues
  - Internalisation of externalities from each set of policies crucial.
  - Inter-dept/agency coordination (Whole-of-Government approach).
  - Access to common information set and diverse expertise.

Singapore's Approach in the Property Mkt



- Some practical guidelines.
  - Targeted
  - Incremental
  - Multi-pronged
  - Structural and cyclical components to tools
  - Prevent price drift