Flexible Inflation Targeting
สำหรับประเทศไทย

Monetary Policy for the 21st Century

January 20-21, 2000

Background: Rationale of the Study

- In Context of Sufficiency Economy, Good Governance, Transparency, & Change in ER Regime July 2, 1997
- How Should Monetary Policy Adjust?
  - Principles & Targets
  - Instruments & Time Frame
- Potential Impacts on
  - Credibility
  - Speculation Vulnerability
  - Growth & Stability
- Aim to Enhance
  - Efficiency, Transparency & Accountability

What Monetary Policy Can/Cannot Do?

- Activist MP (Phillips 1958, Samuelson and Solow 1960)
  - Believe Growth Manageable because of LR trade-off between Inflation & Unemployment =>
  - Failed: Economic Cycle Persisted
    - late 60s and 70s ~ high inflation,
    - 73-74 & 81-82 ~ severe recessions

- Three major Critics
  - Milton Friedman: MP works with long & variable lags
    - Lucas: Rational Exp => Game theory => Lack of Precision of MP
    - Myopia & SR Pressure => Over-active Tendency => Instability
  - Friedman & Phelps: No LR Trade-off between p' & unempl
  - Importance of "Credibility" (infl bias) on Effectiveness of MP

Rationale for Inflation Targeting
Bernanke et al. (1999)

- MP less Confidence in Smoothing Real Economy in SR
  - Inflation is the only variable MP can affect in LR
- Even Moderate Inflation => Harmful against other Economic Goals
- Price Stability => Key Element in Overall Policy Framework
  - To communicate intention to the Public
  - Impose accountability & discipline on policy makers
  - Serve as a nominal anchor => reference point of
    - financial markets
    - general public
    - desirability of SR policy

Benefits of Low Inflation = ?

- Hyperinflation (50%-1000%) a year => Poor Ec. Performance
- High Inflation => Over-expansion of Financial System
  - Asset inflation => Over-priced collateral => Fin Fragility
- More resources (Costs) needed to manage cash holding
- Frequent repricing => Increased Costs of Monitoring
- Distribution Effects (usually against Middle Class)
- Relative values of Goods & Services => Not reflect “true” (shadow) prices
  - Inflation => Confusion betw rel & abs Pr => affect decision
  - Inflation => depreciatn on past value of Inv =>
    - Less incentive to invest
    - Diff Sector => Diff Depr Rates => Misallocation of Resources
  - 10% inflation => Est. 2-3% costs of GDP (Fischer 1994)

In search of a Nominal Anchor

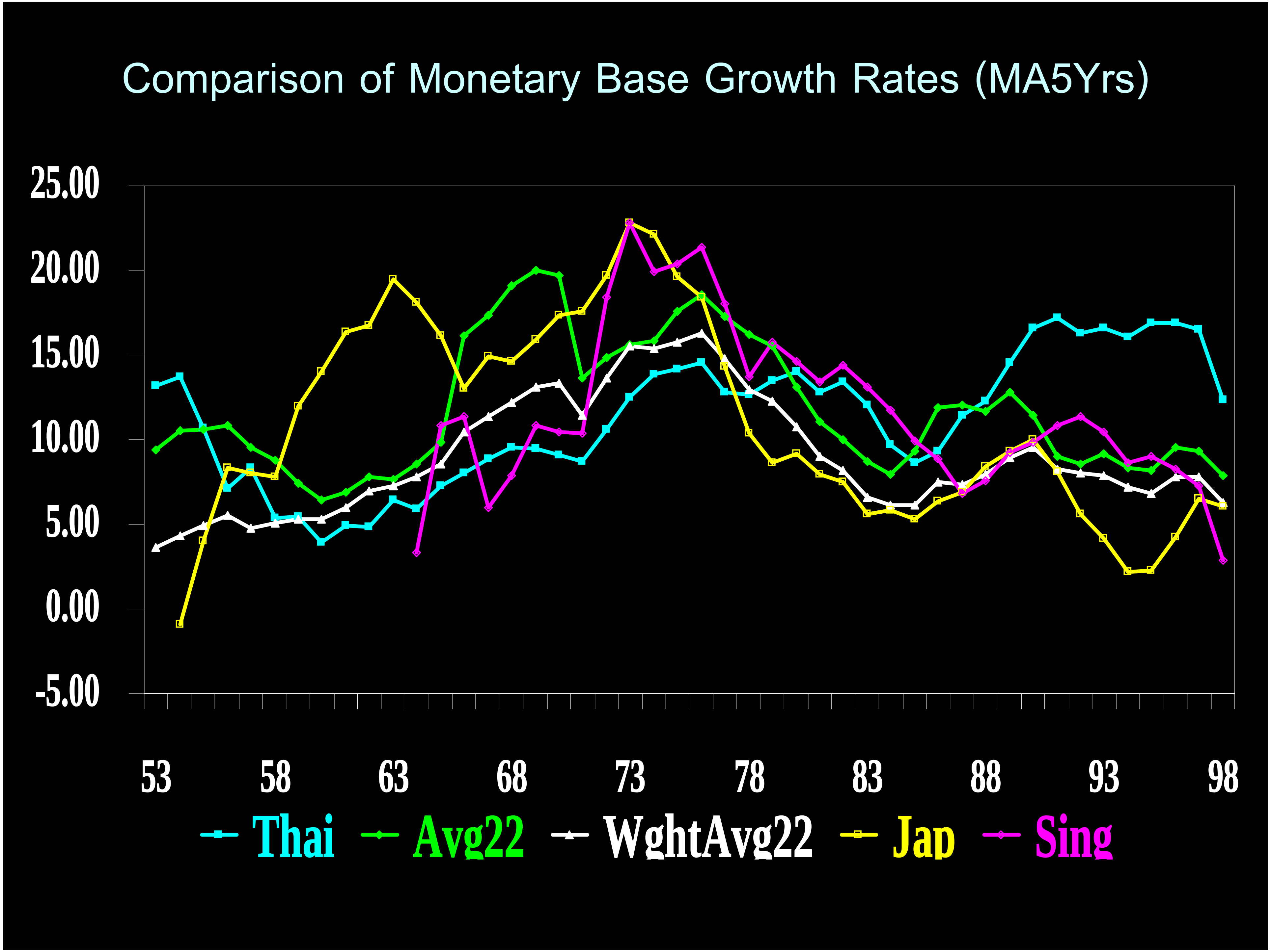
- To Tie Down Pr to a Specific Level => Need MP Constraints
- Nominal Anchor = ?
  - Gold Standard (Abandoned in 1960s)
  - Fixed Exchange Rate (Dropped July 2, 1997)
  - Limit Amount of Paper in Circulation (Less Effective)
  - Inflation Targeting

Inflation Targeting = ?

- A Recent Innovation of Late 1980s & Early 1990s
- IT = Stance of Monetary Policy Depends on
  - Inflation Forecast vs. Inflation Target
- Can Be Both Rule & Discretion
  - Effectiveness depends on Consistency & Commitment
- A Means of Communicating Clearly to the Market

Why Inflation Targeting?

- Decline of Monetary Targeting
  - Due to Financial Liberalization & Innovation
- Shortermism of Monetary Impacts & Rational Expectation
  - High Costs of Persistent Inflation
    - Affecting Both Level & Growth of GDP
    - Cuase Financial Disintermediation
- A Means of Building Credibility Essential for Effectiveness



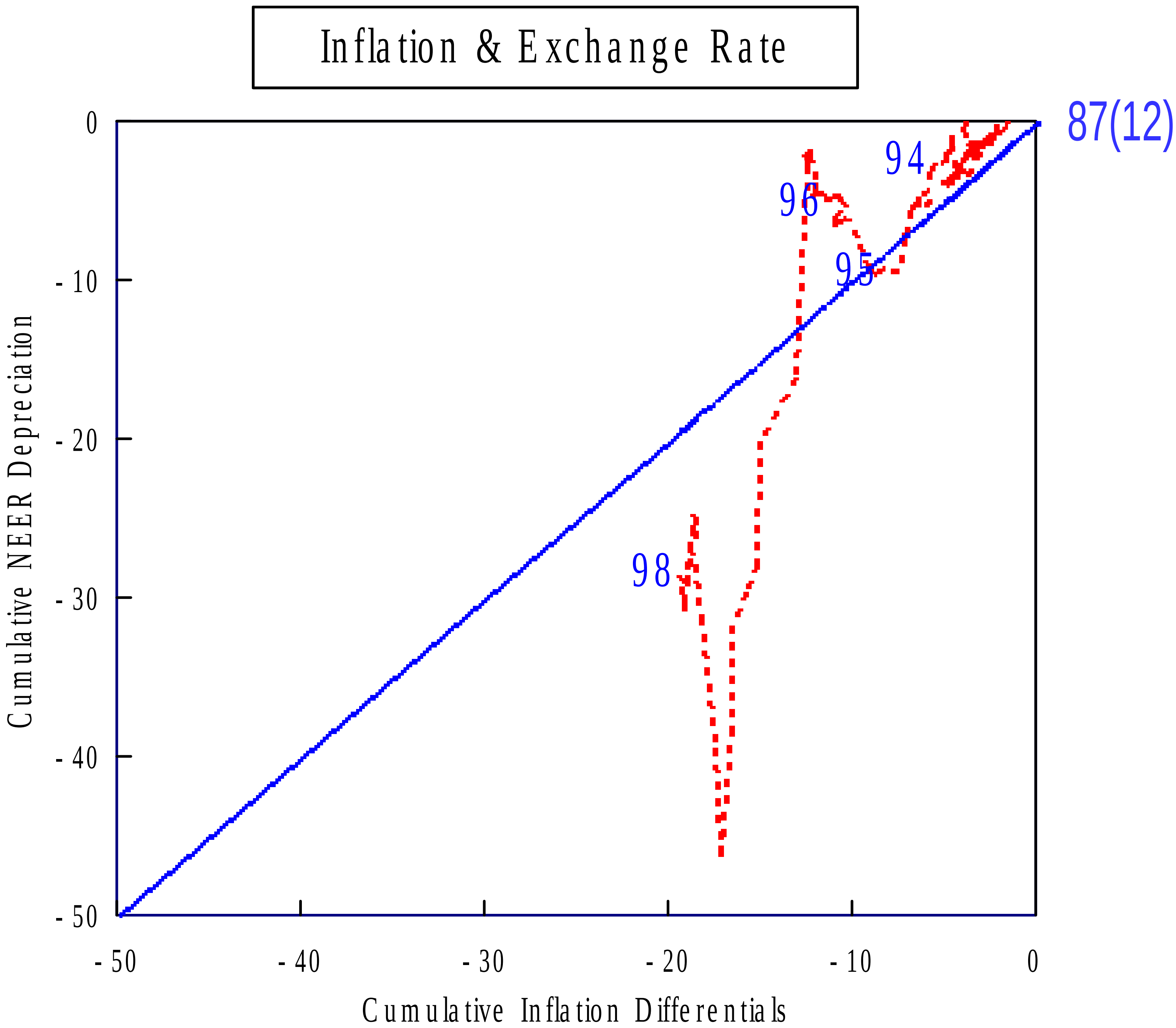
Comparison of Monetary Base Growth Rates (MA5Yrs)
25.00
20.00
15.00
10.00
5.00
0.00
-5.00
53
58
63
68
73
78
83
88
93
98
Thai
Avg22
WghtAvg22
Jap
Sing

Comparison of LT Inflation Performances

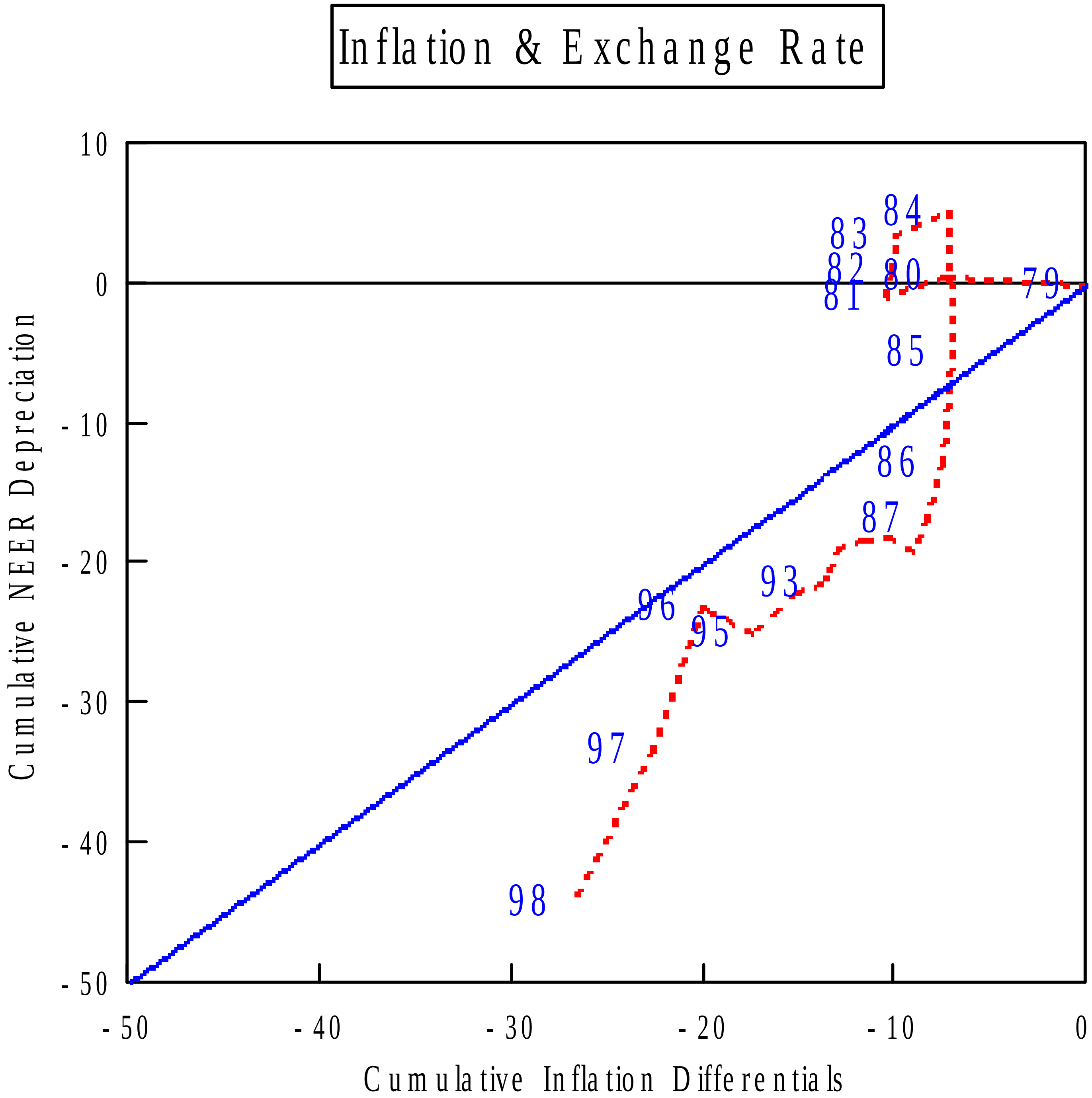
Yrs	Thai	w.a22	Sing	Korea	Malay	Indo	Phil	China
50-59	2.7	2.4	3.4	4.4	2.7		0.5	
60-78	4.9	8.4	3.4	10.6	3.1		9.2	
79-83	10.3	7.3	5.2	15.8	5.9	13.6	13.8	
84-86	1.7	2.6	0.6	2.5	1.7	7.0	24.7	
87-96	4.8	3.2	2.2	6.0	3.4	8.4	10.0	11.2
97-98	6.8	2.2	0.9	6.0	4.0	32.2	7.0	1.0
50-98	4.8	5.4	3.1	8.3	3.3	11.3	8.9	9.5

Thai Inflation Relative to Trading Partners'

	Tr.Partner	Thai	Difference	Cumulative
88:1-97:6	3.45	4.97	-1.52	14.42
97:7-99:6	2.12	5.98	-3.86	-5.05



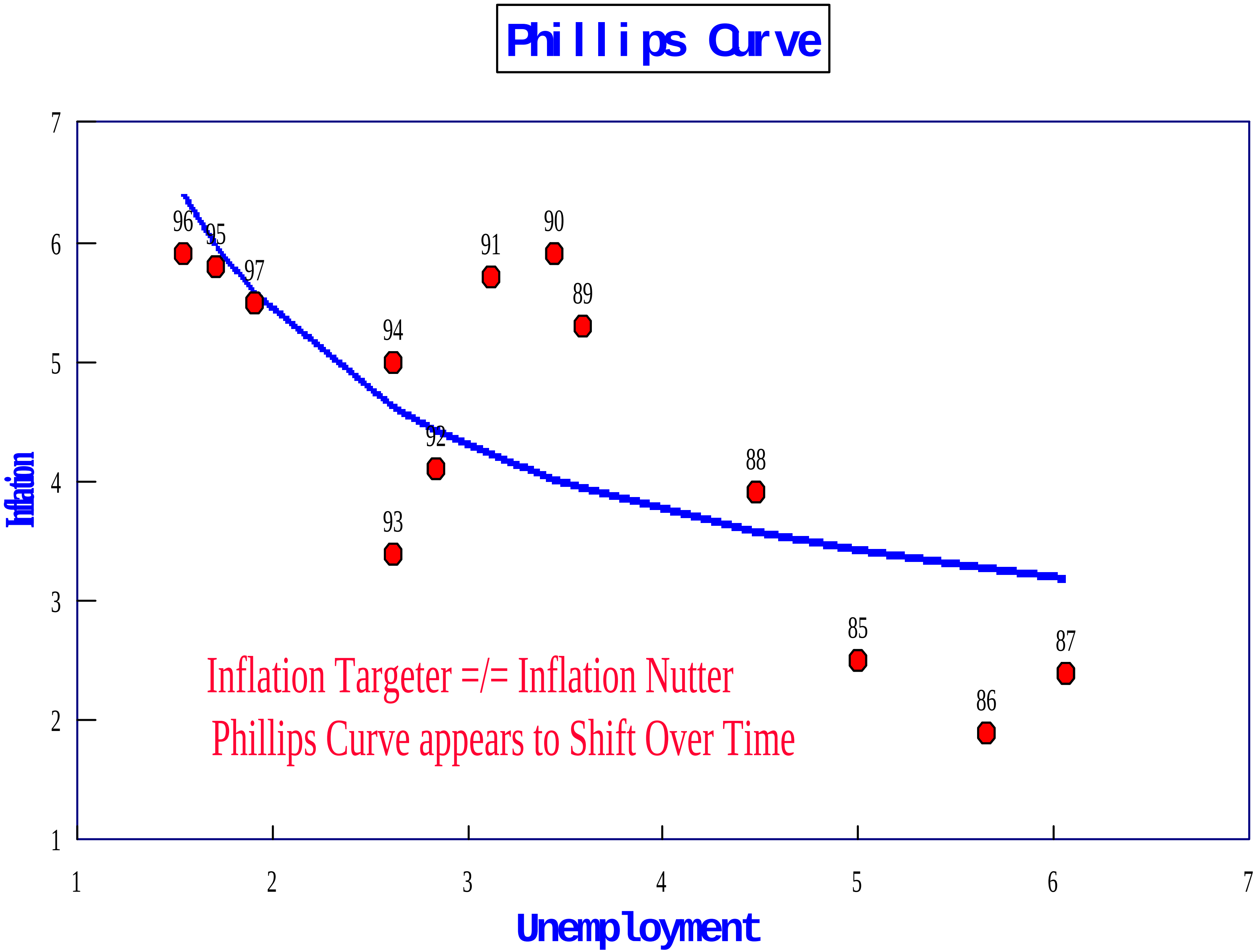
Inflation & Exchange Rate
0
- 10
- 20
- 30
- 40
- 50
Cumulative NEER Depreciation
- 50
- 40
- 30
- 20
- 10
0
Cumulative Inflation Differentials
87(12)
94
96
95
98



Inflation & Exchange Rate
10
0
-10
-20
-30
-40
-50
Cumulative NEER Depreciation
-50
-40
-30
-20
-10
0
Cumulative Inflation Differentials
84
83
82
81
80
79
85
86
87
93
96
95
97
98

International Experiences with IT

- IT => Lower Inflation 1-2 Years after Announcement
- Impact ~not Immediate but Increased with Performances
- IT Does not reduce Growth Cost of Disinflation
  - But Growth Rebounds after Confidence Restored
- IT Helps Alleviate Impacts of Shocks e.g. from
  - Indirect Tax or Exchange Rate Movements
- Forward Looking => Avoid Stop-Go Monetary Policies


Phillips Curve
Inflation
Unemployment
7
6
5
4
3
2
1
1
2
3
4
5
6
7
96
95
97
91
90
89
94
92
88
93
85
87
86
Inflation Targeter =/= Inflation Nutter
Phillips Curve appears to Shift Over Time

How to Do Inflation Targeting? Arts+Science

- Need a Basic Understanding of Inflationary Process
  - Internal vs. External Causes of Inflation & Other Key Variables
  - Impacts of Policy Instruments on Inflation (Magnitude & Lags)
- Require Judgement regarding Trade Off
  - Need Public Understanding on the ST Costs of LT Well-Being
  - Mandate only arises out of Public Consent
  - Socially Acceptable Rates of Inflation, Unempl. etc. => Targets
- Need Policy Coordination: Structural Adjustment, Savings Mobilization, Regional Cooperation & Supervision esp. Derivatives.

The Preparation for Implementation of Inflation Targeting Framework in Thailand

Information & Presentation for Policy-Making,

Public Understanding

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1. Preparing for the Monetary Policy Board (MPB) meeting.
2. Conducting researches supporting Inflation Targeting.
3. Publishing papers/articles
4. Organizing symposium

The Preparation for Implementation of Inflation Targeting Framework in Thailand

Operating Procedures

1. Inflation Target
   - Headline Inflation
   - Monitor Core Inflation
2. Target Instrument
   - R/P rate 14 days
3. Increase the effectiveness of operating procedure by
   - Developing new financial instrument i.e. outright bond operations
4. Public communication i.e. publishes
   - Minutes of MPB meetings.
   - Inflation Report
   - Policy statement in the Government Gazette

The Preparation for Implementation of Inflation Targeting Framework in Thailand

Forecasting Tools

1. Construct quarterly macroeconomic model for making economic forecasts which help recommend monetary policy and evaluate effects of policies and external factors on the economy.
2. Construct leading inflation index and leading economic index.
3. Forecast Inflation using Partial Analysis and Market Expectation.

Practical Issues
Welfare Maximizing Economic Strategy =?

- Depends on Size, Time & Channel of Exogenous Shocks
- Capability in Executing Complex Monetary Instruments
  - Caution against Overreaction
- Frequent Stance Adjustment => Lower Credibility
- Balance between Power & Responsibility

Conclusions

- IT as Means to Rise to New Challenges under New Environment
- Applicability of Conventional Monetary Targeting Become Limited
- Even if Policy Framework Permit, Discipline Needs to be Strengthened
- Coordination is Most Essential
- Monetary Autonomy (seigniorage) is Increased, So will Accountability Have to be Raised.
- Flexibility has to be Biult-in
  - Domestic Objective Function
  - External Competitiveness
  - To Manage ST Shocks
- IT as a Means to Talk / Signal to the Market
  - Lower Conflicts & Utilize Market Power
  - Strengthen Credibility & Discourage Speculation