International Spillovers and Monetary Policy Strategy in Asia: Comment

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Summary of the Paper

- Evolution of monetary policy instruments and strategies in Emerging Asia
- SVAR evidence on interest rates, Fed Funds rate, and US term premium
- Discussion of policy alternatives
- Useful paper, I learned a lot

Monetary Strategy in EM Asia

Changing Views on Strategy

- Paper states that, before global crisis, central banks were transiting towards IT consensus, with emphasis on interest rate control
- Crisis led to a reappraisal of this trend, as in other parts of the world
- “Central banks in Asia have long recognised the usefulness of multiple monetary policy instruments, including balance sheet policies”

Are multiple instruments always useful?

- As stressed in the paper, prior to the global crisis, central bank balance sheet growth was dominated by FX reserves accumulation
- And this was a by product of intervention
- Which, in turn, was a response to appreciation presssures
- Is this a good idea? Not obvious

Latin America before Lehman

- K inflows, commodity prices, food prices, all led to appreciation and high inflation
- Central banks responded by increasing policy rates to lower inflation
- To fight appreciation, unconventional tools, including FX intervention
- This policy mix was, in fact, losing the battle when Lehman hit
- See Céspedes, Chang, and Velasco 2014

Vulnerability and Policy Independence

- Paper: policy rates seem to have become more sensitive to external factors
- This is seen as loss of independence
- But, presumably each central bank still decides on own policy setting
- The question is: why have central banks changed policy rules in this way?

Implications of Financial Globalization

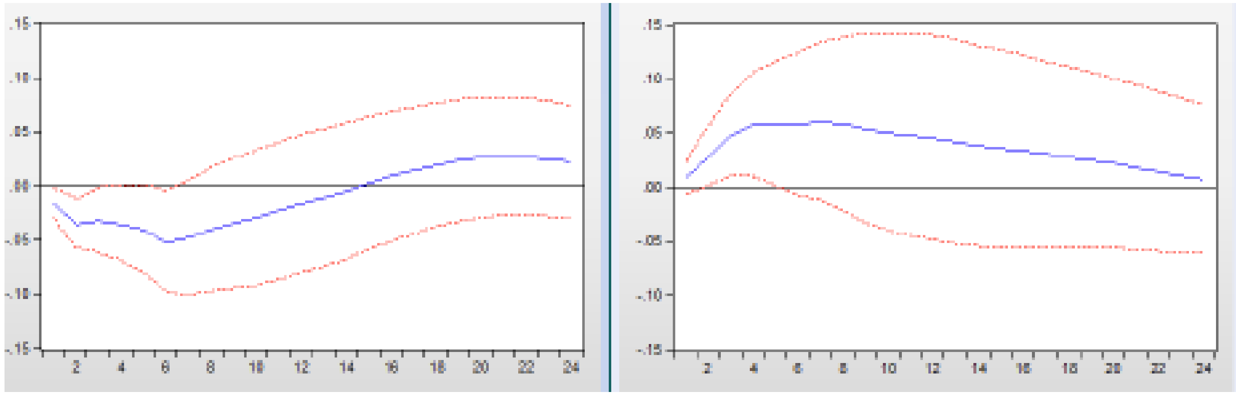
- “Growing evidence that long term interest rates are increasingly driven by global, rather than domestic, factors”
- Term spreads move together
- Possibly a reflection of more volatile world interest rates?

SVAR Evidence

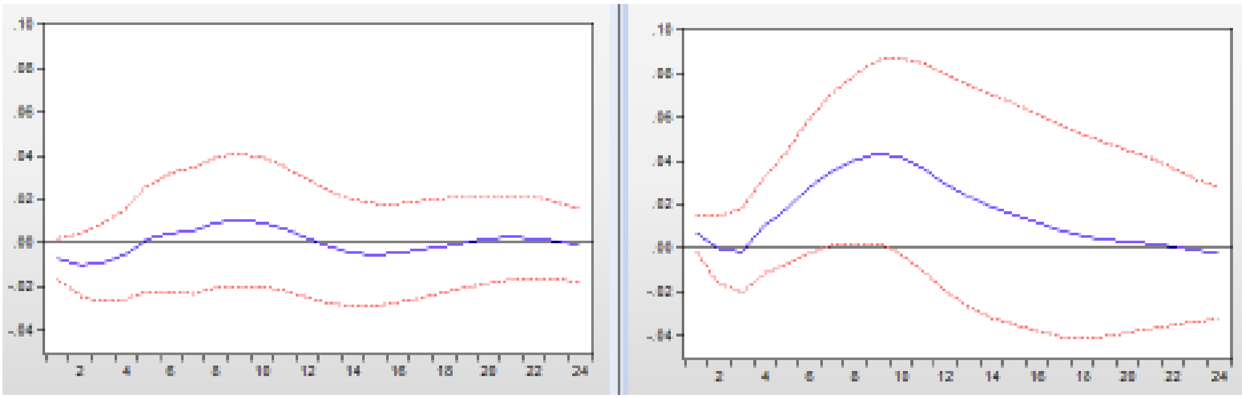
Scope of Exercise

- Analysis of a structural VAR with Y, P, E, i, Y^*, Oil
- Augmented with US policy rate and US 10-year term premium
- Focus on impulse responses to the latter
- Claim: policy rate responds mostly to US term premium, and more strongly since Lehman

Korea



Malaysia



Post Lehman IRs to Fed Funds rate (Left column) and US Term premium

Comments

- Need to look at other IRs (I know it is work in progress…)
- One reason is that we might want to discuss the identification scheme (e.g. is it reasonable to assume E does not react to i?)

		us	oil	ip	inf	neer	ir
US variable	us	x	0	0	0	0	0
Oil prices	oil	0	x	0	0	0	0
Industrial production	ip	x	0	x	0	0	0
CPI inflation	inf	x	0	x	x	0	0
Nominal effective exchange	neer	x	x	x	x	x	0
Overnight interest rates	ir	x	x	x	x	x	x

More Comments

- Again, a main question is why Asian central banks seem to react more strongly to US term premium
- One could presumably construct a story connected to the increase in financial globalization and bond issuance, plus reluctance to allow for appreciation
- But this would have to show up in the IRs

Implications for Policy

On Sterilized Intervention

- The paper is (justifiably) skeptical about the effectiveness and desirability of sterilized FX intervention
- One reason: short lived, small effects
- Another, perhaps more interesting: difficulty of sterilization
- In practice, sterilization has led to credit expansion

Instruments and Objectives

- Paper focuses on “implications for central banks’ instrument design”
- But recent events and literature has stressed implications for central bank objectives too
- Part of the paper’s discussion, such as the reasons to stabilize exchange rates, seem to be more about objectives than instruments

Macroprudential Tools

- Paper argues that Asian countries have long relied on macroprudential measures
- However, the evidence (Table 2) only seems to say that these countries have enacted traditional measures to ensure financial stability
- Little evidence that these measures react to exogenous shocks (e.g. only two countries use countercyclical capital ratios or dynamic provisioning)

Additional Instruments

- Emphasis on “liability-based measures” (i.e. Shin’s tax on non-core liabilities) and debt management
- Is this “monetary” or “fiscal” policy?
- Danger of mission creeping (and implications for central bank independence)