Transcript of Opening Remarks by Dr. Sukhdave Singh, Deputy Governor of Bank Negara Malaysia, at the conference on "The Future Direction of Monetary Policy Frameworks and Strategies in Emerging Market Economies", 21 May 2014

Distinguished speakers, ladies and gentlemen, a very good morning and welcome to our one-day Conference. Let me start off by thanking our international participants who have travelled a long way to be here.

The theme of today's Conference is "The Future Direction of Monetary Policy Frameworks and Strategies in Emerging Market Economies".

How we do monetary policy, and the frameworks that we rely on, has, as you all know, been the subject of active discussion. This is not the first conference on this topic and it will not be the last. To some extent, it reflects the traumatic experience of the crisis in the advanced economies which has cast doubt on many of the conventional wisdoms that guided the conduct of monetary policy before the crisis. The crisis has shown that those frameworks were not only unsuccessful in preserving macroeconomic stability, but may also have narrowed the peripheral vision of policymakers to the risks that were being created in the financial system, and the extent to which the conventional conduct of monetary policy was contributing to those risks.

Let me just say here that I believe that frameworks are useful to guide us, but they should not confine our thinking. As policymakers, we have to be flexible and recognize when we may in some circumstances need to step outside of those frameworks and do things differently. A dynamic and uncertain world requires dynamic policymakers. Nevertheless, we should be very clear about why we are doing what we are doing.

For emerging market central bankers, prior to the crisis we had looked at the advanced economies for best practices and often ended up emulating what the advanced central banks were doing, irrespective of institutional differences and differences in economic and financial circumstances. This had its benefits. For example, in some emerging economies, the adoption of inflation targeting freed monetary policy, in many instances, from the yoke of fiscal domination, and in my view, it was the later rather than the framework itself that brought down inflation in these economies.

On the other hand, central bankers in emerging markets have sometimes struggled to weld policy frameworks that did not fully capture the economic realities they faced.

This conflict was most evident among very open emerging economies that had adopted monetary policy frameworks from relatively closed advanced economies. Not only do “framework optimal” monetary policies lead to conditions that inspire credit booms and financial imbalances, but external developments can have a significant impact on the exchange rate and the ability of emerging market central banks to conduct independent monetary policy. So many central banks have been practising “flexible inflation targeting,” but the definition of that concept has over time become rather ambiguous, to the extent that one could ask: “When is flexible inflation targeting so flexible that it is no longer inflation targeting?”

I suppose the question facing us in emerging market central banks is, this time around do we want to be part of the conversation on how monetary policy should be conducted, or do we again leave it to the advanced economies and then adopt for ourselves whatever they come up with? It is my hope that we would want to be part of that conversation.

So what should emerging market central banks be thinking about? We obviously share some of the core issues with our colleagues in the advanced economies, for example, in areas such as how to optimally bring financial stability considerations into the conduct of monetary policy. But what are the issues of particular concern for monetary policy makers in emerging market economies? I do not have the time to go into that question fully, but let me just mention a couple of issues.

I think we still do not fully understand the implications of conducting monetary policy in a highly integrated world. One of the key questions facing us as policymakers in emerging economies is how to maintain monetary independence in a global monetary environment that is largely determined by central banks in the large advanced economies. Raghuram Rajan, Governor of the Reserve Bank of India, recently wrote about “competitive monetary easing.” Effectively, in a world awash with liquidity, it implies a fear-based strategy of not wanting to attract large capital flows to your shores by avoiding having too attractive an exchange rate or interest rate levels. The question related to adopting such a monetary strategy would relate to its consistency with domestic macroeconomic and financial conditions, and the possible risks it can give rise to if it is not.

In an integrated world, we cannot be oblivious to what others are doing beyond our borders. It is interesting to note that the issue has transcended emerging market economies. In fact, the loudest voices on this issue have been heard in the advanced economies – first, in Japan and now in Europe. If we listen to some of the conversations going on recently in Europe on why the ECB should ease monetary policy further, there are clear undertones related to the strength of the Euro. When you consider how much more open some emerging market economies are compared to these advanced economies, can the issue be any less urgent to policymakers in these emerging economies?

There are other questions. Can we have a monetary policy framework or strategy for the conduct of monetary policy that is optimal for both the advanced and emerging economies, and for all emerging economies? If so, what should be the key elements of that framework? How should be deal with the prevalence of price shocks in many EMEs, including those created by government adjustments to administered prices? If the lesson from the crisis is that monetary and financial stability are symbiotic, how should we set up the governance framework for the conduct of these policies to ensure that there are no blind spots and that things do not fall between the cracks? While many economies in this region have used macroprudential measures for many years now, can we have a framework which clarifies the relative roles of interest rates and macroprudential and micro-prudential measures, leveraging on their complementarity?

More broadly, there are deeper issues relating to the appropriate conduct of monetary policy. Let me just mention two:

First, can we continue with the way monetary policy has been conducted, with successive rounds of monetary policy easing and tightening, but with a progressive bias towards easing and maintaining low interest rates for sustained periods? The question is that if policymakers do not allow the economy and financial system to periodically work out the imbalances that emerge for fear of undermining growth, than would those imbalances not tend to build-up over time? If we adopt a strategy of flooding the financial system with liquidity, would the amount of liquidity we pump in not have to keep increasing to keep those rising imbalances submerged? Such a strategy may keep demand growing, but is it a strategy for sustainable growth?

Second, does it make sense after the experience of the crisis to still talk about an optimal monetary policy framework, or should that framework be more situational or circumstances specific? Or is it that we need more specific frameworks that incorporate all the things that we care about but which our frameworks currently do not provide for?

Ladies and gentlemen,

I hope that today will be an opportunity for us to take a step back and reflect upon some of the elements of our monetary policy frameworks and strategies. It is an opportune time to do so. If the world around us changes, we must consider whether and how monetary policy needs to change also. Clearly, some things that we thought were possible with monetary policy before the crisis have proved to be impossible, and other things that we thought were impossible have turned out to be very possible. What does this imply about the way forward?

With that in mind, we are going to set the ball rolling this morning with a keynote lecture by Dr. William White, Chairman of the Economic and Development Review Committee at the OECD. Now, Bill is no stranger to those of us in central banking. He has had a distinguished career as an economist, has been a member of the central banking fraternity and has been closely associated with central banking for most of his career. He was a Deputy Governor at the Bank of Canada and the Chief Economist at the BIS. He has been a source of many insights into issues related to central banking, particularly on the conduct of monetary policy. In a world dominated by economists whose mother tongue is mathematics, it is always refreshing to listen to someone like Bill, who with his deep knowledge of economic history is able to bring fresh perspective to contemporary economic and financial issues. You cannot sit across the table from Bill and not walk away learning something new. In my interactions with Bill over the years, he has rarely disappointed, certainly not in his sense of humour, but also in his intellectual insights into the bigger picture of issues confronting us as central bankers.

Let me now conclude by once again thanking you for being here today and joining us in this conference. I do hope that you will have a day that is well spent and intellectually rewarding.

May I now invite Bill to take the podium to deliver his lecture.