BSP International Research Conference
“The Evolving Role and Limits of Monetary Policy:
New Perspectives for Emerging Market Economies”

Closing Remarks
Deputy Governor Diwa C. Guinigundo

Governor Amando Tetangco, Jr.,
Deputy Governor Philip Lowe,
Deputy Governor John Murray,
Senior Adviser Ad van Riet,
Members of the Monetary Board [those present],
My fellow central bankers,
Esteemed participants and guests,
Good afternoon.

We have had very engrossing roundtable discussions — listened to these engaging exchanges of ideas and insights, and all too soon, almost unbelievably, the conference is at an end.

But, indeed, this international research conference has been timely and relevant as the Global Financial Crisis has set a watershed for monetary policy. The low policy rates of advanced economies and the consequent surges of capital flows have created challenges for monetary policymaking. Subsequently, there were major shifts in the structure and regulation of the financial sector and these changes may have affected the transmission mechanism of monetary policy.¹ Many economic commentators would say that monetary policy is now “in the new normal.” This is what we have focused on in this conference.

Allow me to give a quick review of the past two days –

Session 1 was the conference opener - a discussion of various monetary policy reactions to capital flows volatility and the risks arising from asset price misalignments:

• Professor McNelis’² explanation of the benefits of a monetary union as an alternative to the usual debate between fixed and flexible exchange rate regimes; how the funding provided by a monetary union could provide an additional cushion in times of adversity.

• Lian and Shahrier and Sharifuddin and Ling’s examination of the effects of capital flows on the asset market. First, by studying the 4 ASEAN countries (Indonesia,

² Paul McNelis (Fordham University), “Finding stability in a time of crisis: Lessons of East Asia for Europe”
Malaysia, the Philippines and Thailand), Lian and Shahrier\(^3\) found that capital flows have a small impact on asset price boom and subsequent bust. Nonetheless, for the housing market in particular, they found that excessive deviations of house prices from their fundamental values cause asset price misalignments.

Sharifuddin and Ling\(^4\), on the other hand, found that the flattening yield curve in Malaysia since 2004 has been driven by an increase in portfolio inflows and further affected by structural issues in the still developing bond market of Malaysia. The higher presence of foreign investors in the domestic bond market was significant in contributing to the decline in long-term yields.

- The issue becomes important as Perrelli and Roache\(^5\) observed the decline in the neutral real interest rates of emerging markets in the decade through mid-2013; they identified the main factors contributing to the decline and estimated neutral interest rates in Brazil as a case study.

- Meanwhile, Majuca and Dacuycuy\(^6\) using an open economy Dynamic Stochastic General Equilibrium (DSGE) model for the Philippines, focused their analysis on how economic shocks affect macroeconomic outcomes. Their study highlighted the role of remittances in stabilizing the Philippine foreign exchange market, acting as a safeguard against unwanted fluctuations and providing support to economic activities of households and firms.

Session 2 focused on the effectiveness of tools available for monetary policy given the increasing inflationary pressures:

- As many central banks – notably the United States Federal Reserve - are already at the zero lower bound, this topic becomes important. Chen, Filardo, He and Zhu\(^7\) analyzed the cross-border effects of the US monetary policy at the zero lower bound on 17 major advanced and emerging economies. The policy had significant domestic impacts - their simulations show that the policy prevented two recessions in 2011 and 2012 and a persistent deflation. Spillover effects on other countries, however, were diverse depending on the stage of the business cycle.

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\(^3\) Chuah Lay Lian and Nur Ain Shahrier (Bank Negara) “Decomposing capital flows and assessing the impact of capital flows on asset markets: Empirical evidence from the ASEAN-4 countries”

\(^4\) Shakira Teh Sharifuddin and Loke Po Ling (Bank Negara), “Flattening yield curve amidst rapid inflows: The Malaysian experience”

\(^5\) Roberto Perrelli and Shaun Roache (International Monetary Fund), “Time-varying neutral interest rates in emerging markets”

\(^6\) Ruperto Majuca and Lawrence Dacuycuy (De La Salle University), “An open economy DSGE model for the Philippines”

\(^7\) Qianying Chen (IMF), Dong He (Hong Kong Monetary Authority), Andrew Filardo (Bank for International Settlements) and Feng Zhu (BIS), “Global impact of US monetary policy at the zero lower bound”
• Meanwhile, Floro, Basilio and Van Roye\(^8\) examined the influence of financial stress on monetary policy behavior. Their paper presented strong evidence of policy switches by central banks in both advanced economies and emerging market economies driven by the intensity of financial stress.

Presentations in Session 3 focused on the interplay between monetary policy and macroprudential policy to achieve both price stability and financial stability:

• Such a coordination is important given that macro-financial linkages, as noted by Kim and Zhu\(^9\), have played a significant role in economic fluctuations in Asian economies. As determined, trend growth depends on long-term financial sector developments, but equity prices and bank lending rely on real GDP mainly in the business-cycle and higher frequencies. The business-cycle link between bank lending growth and economic growth is weak, in contrast to the link between stock market and business cycles. Also, macro-financial linkages change over time and differ significantly across emerging Asian economies due to the different levels of financial sector development and distinct policy and institutional frameworks.

• By incorporating a fully-specified banking sector in their DSGE model, Anand, Delloro and Peiris\(^10\) provided a better explanation of the role of bank intermediation in the transmission of monetary impulses, and analyzed how shocks that originate from credit or interbank markets are transmitted to the real economy. Results showed that the tightening of credit markets (represented by a persistent negative shock to bank capital) can have substantive effects on the economy as banks rebuild capital to compensate for the loss in equity. When the central bank resorts to using non-monetary tools, such as cash reserve and statutory liquidity requirements that result in domestic banks holding a greater share of government securities, a larger contraction in output and consumption results as compared to traditional monetary tightening (operating through nominal interest rate changes).

• Similarly, Harmanta, Purwanto, Rachmanto and Oktiyanto\(^11\) developed a DSGE model for Indonesia that included financial frictions in the form of collateral constraints among households and a financial accelerator among entrepreneurs. The model showed that shocks in the banking sector, such as an increase in the capital adequacy ratio (CAR) requirement, impact the real sector through the credit channel, which slows down GDP and lowers the rate of inflation.

\(^8\) Danvee Floro (BSP), Joselito Basilio (BSP) and Bjorn van Roye (University of Kiel, Germany), “The responsiveness of monetary policy to financial stress: A dynamic panel threshold analysis”

\(^9\) Hoon Kim (Bank of Korea) and Feng Zhu (BIS) “Estimating macro-financial linkages in Asia”

\(^10\) Rahul Anand (IMF), Vic Delloro (BSP) and Shanaka J. Peiris (IMF), “A credit and banking model for emerging markets and an application to the Philippines”

\(^11\) Harmanta, Nur M. Adhi Purwanto, Aditya Rachmanto and Fajar Oktiyanto (Bank Indonesia), “Monetary and macroprudential mix under financial frictions mechanism with DSGE model: Lessons from Indonesian experience”
Simulations showed that a policy mix of monetary and macroprudential policy achieves sustainable GDP and stable inflation.

- Jannsen, Potjagailo and Wolters\textsuperscript{12}, on the other hand, analyzed the effectiveness of monetary policy during episodes of financial crisis compared to non-crisis periods and observed that monetary policy has, to some extent, a larger effect on GDP during financial crises than in non-crisis periods, with GDP reacting faster to changes in monetary policy.

And, finally, Session 4 - the newly introduced segment of the conference, the roundtable discussion. The idea was to have central bankers present perspectives on the changing landscape of monetary policy. How truly fortunate to have three seasoned central bankers grace this “inaugural” roundtable discussion. I believe everyone will surely agree with me that the presentations by Phillip Lowe, John Murray, and Ad van Riet, and the subsequent discussions, provided valuable and practical insights on monetary policymaking.

Needless to say, we shall all be able to refer to these papers and presentations later on as all of these will be included in a conference volume to be published in 2015.

Two years from now, in 2016, the BSP will hold its next conference. There will probably be new economic issues then. Will we have learned much by then to guide us in policymaking? Would we have answered the questions that have been raised in the past two days? Or will new twists and turns in global developments take us to uncharted monetary policy realms?

But until then, on behalf of the Governor and Monetary Board members, our heartfelt thanks to the speakers, session chairs, presenters, discussants and all participants for your excellent contributions to the conference. We will be happy to see old friends again in 2016, and look forward to meeting new ones. In the meantime, economists that we are, I know that we will all be monitoring developments in the global financial markets, and working really hard to master the art of monetary policy.

Thank you.

\textsuperscript{12} Nils Jannsen (Kiel Institute for the World Economy), Galina Potjagailo (University of Kiel, Germany) and Maik Wolters (University of Kiel, Germany), “Monetary policy during financial crises: Is the transmission mechanism impaired?”