Good morning and welcome to the 2014 International Research Conference of the Bangko Sentral ng Pilipinas (BSP). The theme of this conference – “the evolving role and limits of monetary policy” – has attracted a great deal of attention since the beginning of the Global Financial Crisis.

Rethinking Monetary Policy

In 2007, the world was hit by what Alan Greenspan described as a “once-in-a-century credit tsunami” that forced a rethinking of monetary policy. For one, how monetary policy interrelates with financial stability has been given due attention. Before the crisis, a common view, which was supported by research, was that achieving price and output stability would promote financial stability. However, the crisis revealed an important limitation of monetary policy – that even when monetary policy successfully achieves price stability, financial stability is not guaranteed. Low and stable rates of inflation may foster asset price bubbles or overly optimistic expectations. Accommodative monetary policy may give incentives for banks to over-leverage and take on more risks. These actions, in turn, may threaten financial stability.

There is now also recognition that financial stability is essential for an effective monetary policy. The fragility of the financial sector can affect the transmission mechanism of monetary policy and its impact on the real economy, and the outlook for price stability. In times of financial instability, attempts to use monetary policy to stabilize inflation may be muted, since linkages from monetary policy to the financial sector and the real economy are disrupted.

The crisis has likewise demonstrated that global factors have become increasingly important in the transmission of monetary policy and in shaping domestic economic outcomes. Changes in foreign monetary policy alter the movement of capital from one country to another, thereby influencing domestic liquidity conditions, the exchange rate, domestic interest rates and market expectations, among others.

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1 Welcome remarks of Monetary Board Member Felipe M. Medalla at the Opening Ceremony of the 5th BSP International Research Conference on 28 October 2014 at the BSP Executive Business Center.
2 Alan Greenspan’s testimony before the House of Representative’s Government Oversight Committee on 23 October 2008
3 Mishkin (2011)
4 See for instance and Bernanke and Gertler (2001)
Evolving Views on Monetary Policy

Academics as well as policymakers have argued that these developments call for a revamp of monetary policy frameworks. First, questions are being raised as to whether the monetary policy rule has to explicitly include financial stability concerns. However, the relative weight monetary policy should assign to financial stability remains ambiguous. Nonetheless, identification of potential conflicts between financial and price stability and on ways to improve on potential tradeoffs have to be intensified.

Related to the foregoing, the importance of macroprudential policy to complement monetary policy has come to the fore. When monetary policy is constrained to address price stability, targeted macroprudential measures can be tapped to address specific sources of risks.

Second, as global factors have become increasingly important in influencing domestic outcomes, the set of information variables as well as the policy toolkit of central banks should be expanded. A greater understanding of how various aspects of the monetary transmission mechanism are affected by global factors has become necessary to ensure the effectiveness of policy instruments.

Third, there is now greater importance placed on the possibility of multilateral coordination of monetary policies to appropriately internalize spillovers. Such thoughts suggest that monetary policy may need to give due attention to its international ramifications, especially on capital flows and on financial stability in foreign jurisdictions.

These considerations clearly have an important bearing on the future of central banking, in general; and on monetary policy making, in particular.

Monetary Policy Strategy in the Philippines

To put these issues in context, let me now turn to the experience of the Philippines. Throughout the crisis, the primary objective of the Bangko Sentral ng Pilipinas (BSP) remained to be “to maintain price stability”. Nonetheless, financial stability is an important pursuit. Policy instruments were used in increasingly innovative ways, and the BSP policy toolkit was broadened to address evolving economic conditions. This strategy ensures that monetary policy is not overburdened in achieving both price and financial stability.

Among the adjustments in the BSP’s monetary policy instruments include the following:

- Rationalization of reserve requirement policies as befit market conditions
- Revisions of policies on the use of BSP fixed-term deposits

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5 IMF (2013)
6 Ostry et al. (2012)
Participation in the foreign exchange market to dampen exchange rate volatility and accumulation of foreign exchange reserves

Some non-monetary policy measures implemented by the BSP have proved particularly helpful in maintaining financial stability; to name a few:

- Development of risk assessment tools to monitor developments in the financial and foreign exchange markets for early detection of signs of distress
- Full adoption of the new capital requirements of Basel III on January 2014
- Expansion of definition of real estate exposure to restrain credit growth in the sector as well as conduct stress test to ensure banks have sufficient capital to cover their real estate exposures
- Formal coordination across government agencies through the creation of the Financial Stability Coordination Council (FSCC) to identify, manage and mitigate the build-up of financial risks emanating from both financial and non-financial sectors of the economy

The tools implemented and endeavors pursued by the BSP are supported by high-quality supervision, sound regulatory framework & effective enforcement. These are likewise clearly communicated to ensure maximum compliance by banks and appreciation by our stakeholders and the public.

The Conference Sessions

Our two-day conference will touch upon many issues important to monetary policy and financial stability. Papers will review how emerging markets were affected by movements in capital flows, the risks associated with these flows, and how monetary policy responded. There will also be a discussion on the challenges facing central banks and the effectiveness of their available tools during financial crisis. And the interplay between monetary policy and macroprudential policy will be analyzed.

These topics are particularly important as central banks continue to face challenges in monetary policy making. We have brought together experts with a wide range of backgrounds, including policymakers, and those working in international research institutions and academia, to exchange ideas on these issues. I thank the authors and your respective institutions for your valuable contribution to this research conference.

To top off our two-day conference, we are privileged this year to have a panel discussion comprised of distinguished central bankers – Deputy Governor Philip Lowe of the Reserve Bank of Australia; Former Deputy Governor John Murray, from the Bank of Canada; and Senior Adviser Ad van Riet of the European Central Bank. The experience and expertise of these gentlemen in policy making promise to provide an insightful discussion on the role, limits and future of monetary policy, using the case of their respective economies. Thank you, gentlemen, for gracing the BSP International Research Conference.

I invite all of you to engage yourselves in the sessions as this conference promises to provide a good opportunity to learn and share ideas on the conduct of monetary policy.
Conclusion

As I end, let me refer to Milton Friedman who said that “Only a crisis - actual or perceived - produces real change. When that crisis occurs, the actions that are taken depend on the ideas that are lying around. That, I believe, is our basic function: to develop alternatives to existing policies, to keep them alive and available…” 7

Indeed, the recent crisis has brought us challenges, compelling policy-makers to enhance existing policies and expand toolkits. It is my hope that the shared ideas in this conference will further expand our alternatives to existing policies that will reinforce our capacity to deal with future challenges.

I wish you well in this Conference and I look forward to a productive and interesting exchange of ideas. Thank you very much for your participation and a pleasant morning to all.

References


