



Monetary Policy Transmission Mechanisms in Pacific Island Countries

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Outline

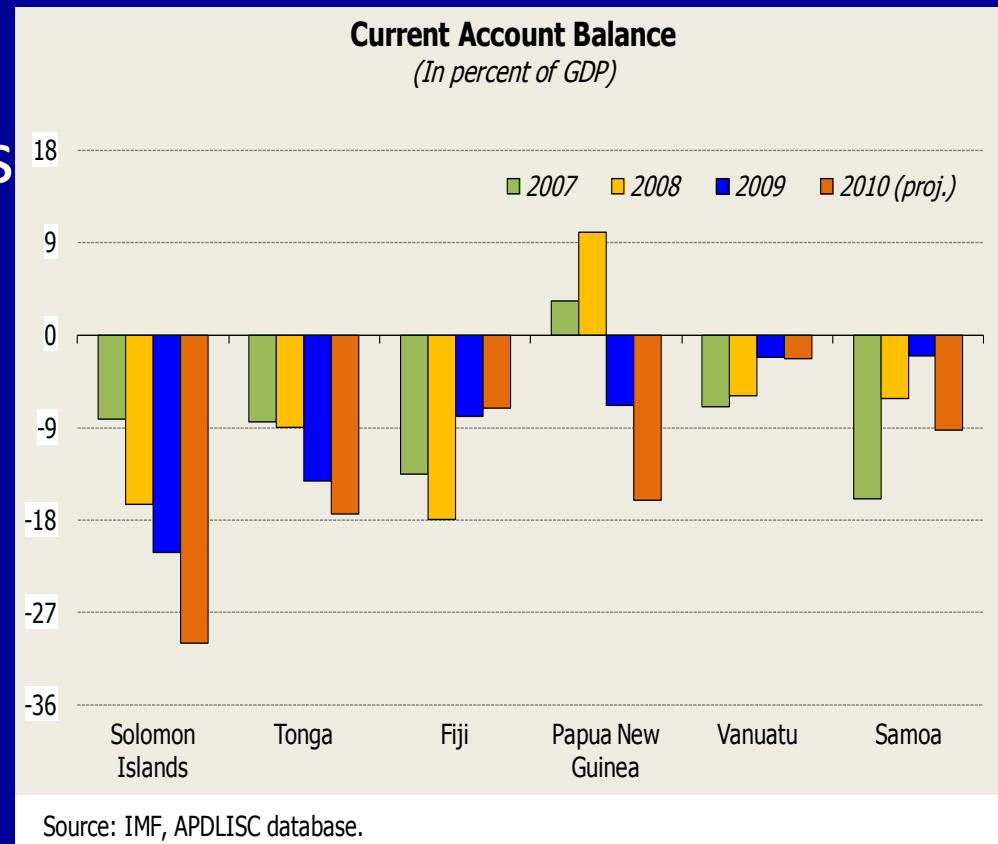
- Motivations
- Monetary policy objectives and operations
- Interest and credit pass-through
- Constraints on monetary policy transmission
- Macroeconomic policy coordination
- Conclusions

Countries Covered

- Six countries with their own currencies:
 - Fiji
 - Papua New Guinea
 - Samoa
 - Solomon Islands
 - Tonga
 - Vanuatu

Monetary Policy Objectives

- Preserving international reserves
- Maintaining price stability
- Ensuring financial sector stability
- Promoting growth and development



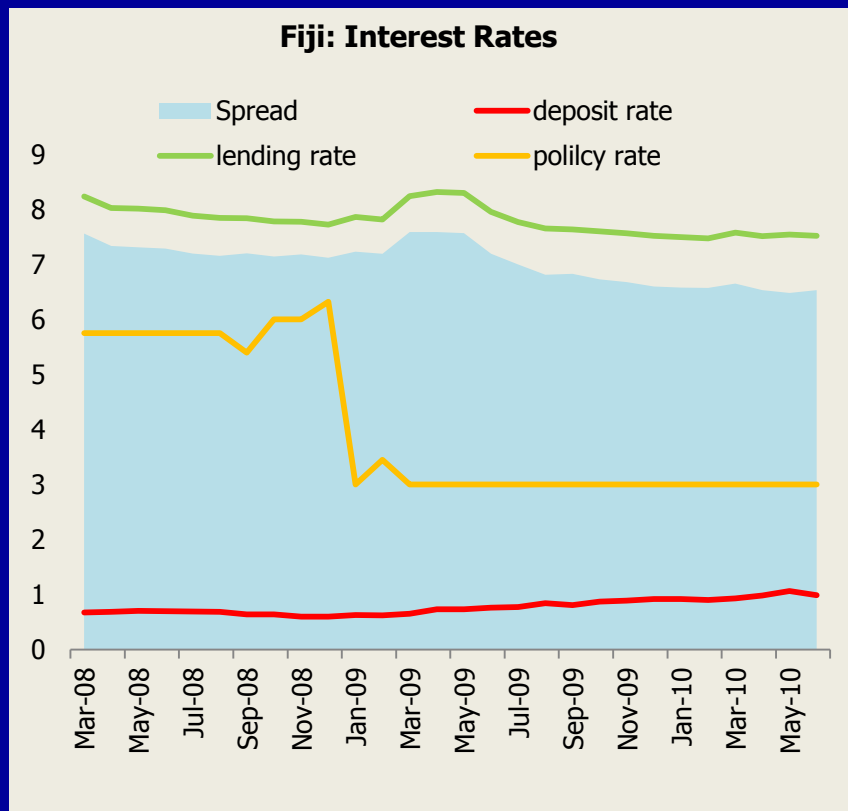
Monetary Operations

- Money targeting frameworks
 - M2/M3
- Policy instruments
 - Policy rates
 - OMO
 - Discount windows
 - Reserve/liquid asset requirements
 - Direct controls—e.g., credit limits
- Mostly fixed exchange rates

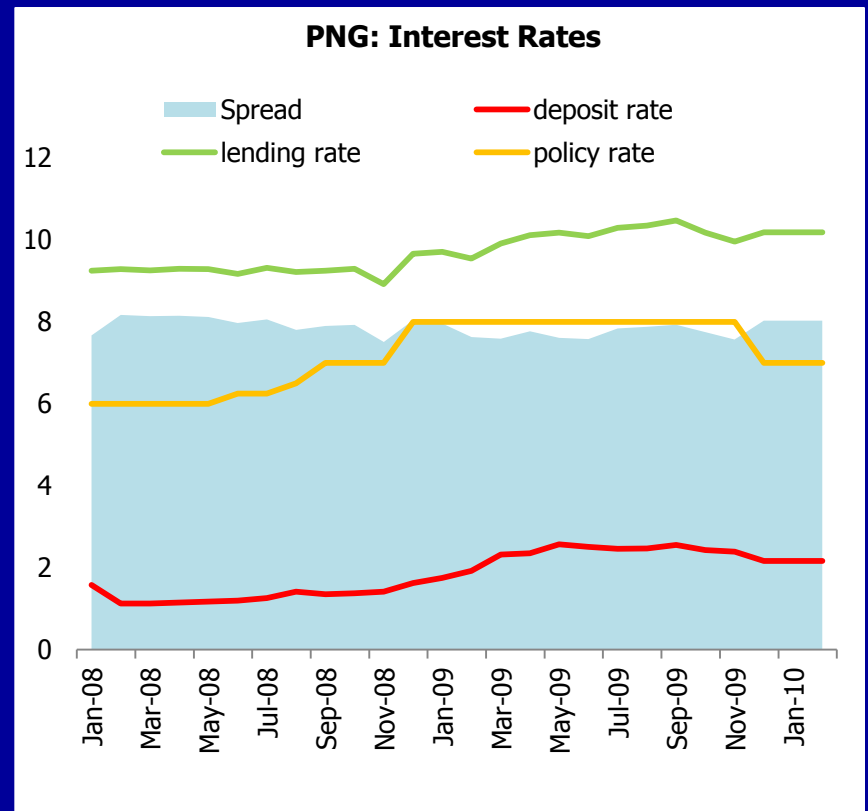
Interest Rate Pass-Through

Fiji and PNG

Sometimes large changes in policy rate; limited changes in bank rates

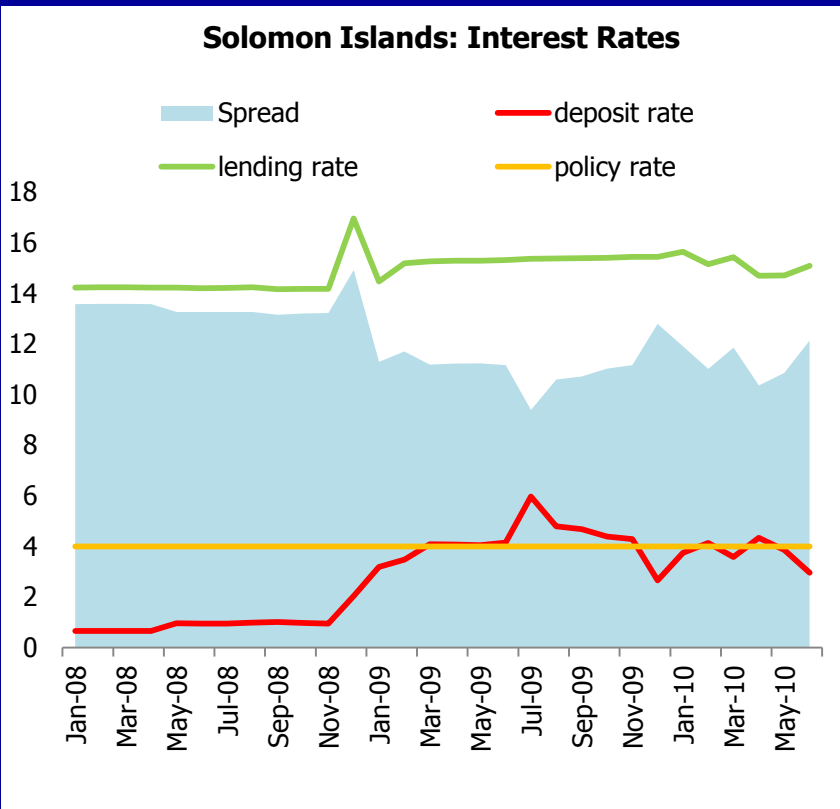


Frequent changes in policy rate; greater response in bank rates

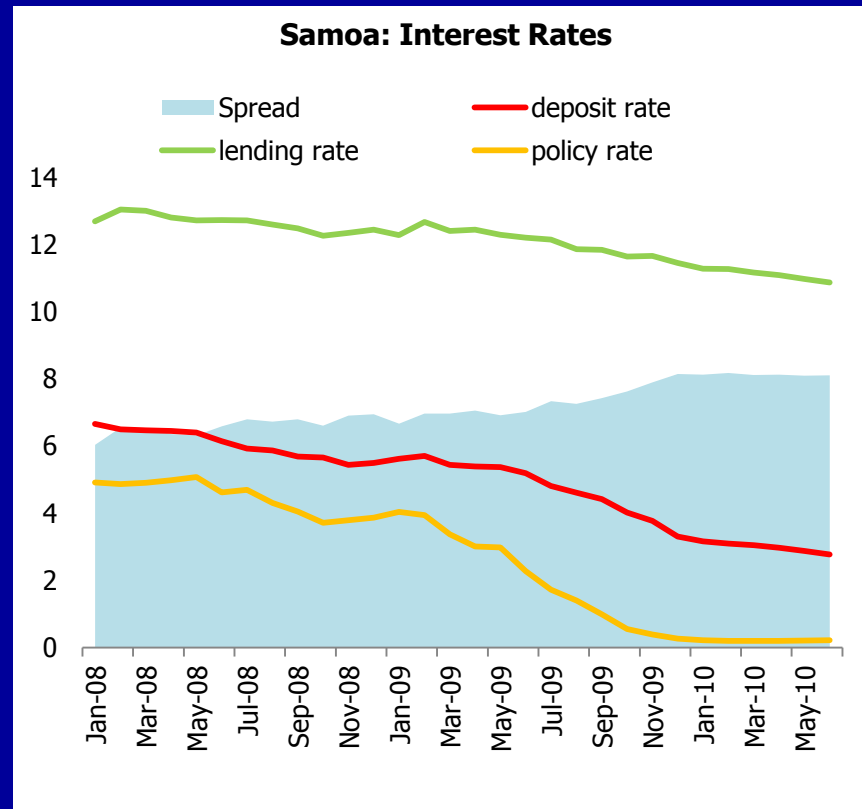


Interest Rate Pass-Through Solomon Islands and Samoa

No changes in policy rate; lending rate is high and deposit rate changes are large



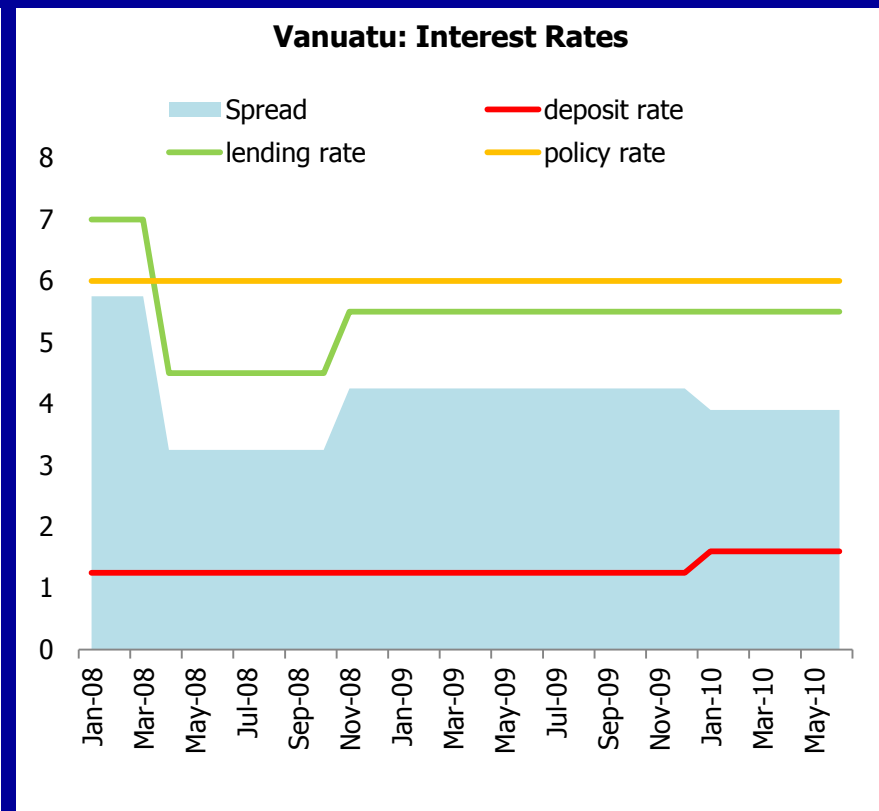
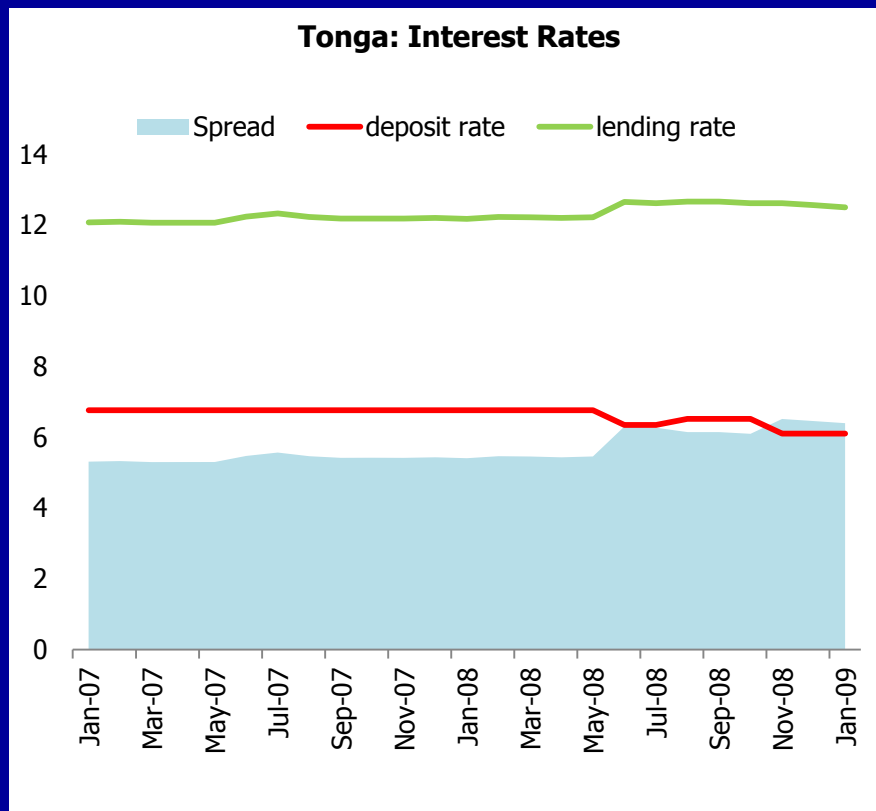
Frequent and larger changes in policy rate; greater response in bank rates



Interest Rate Pass-Through Tonga and Vanuatu

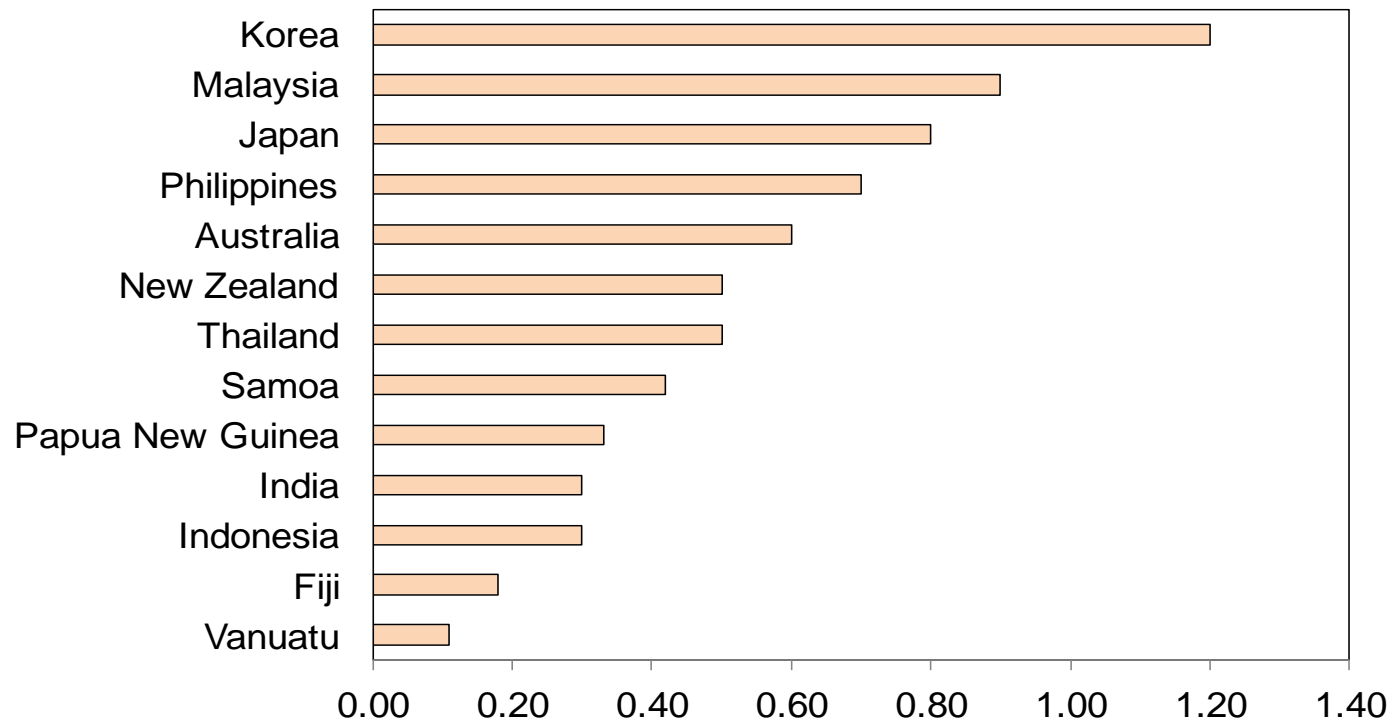
No policy rate; limited changes in bank rates

No change in policy rate; infrequent changes in bank rates



Interest Rate Pass-Through (from policy rate to lending rate)

Long-run Interest Rate Passthrough¹



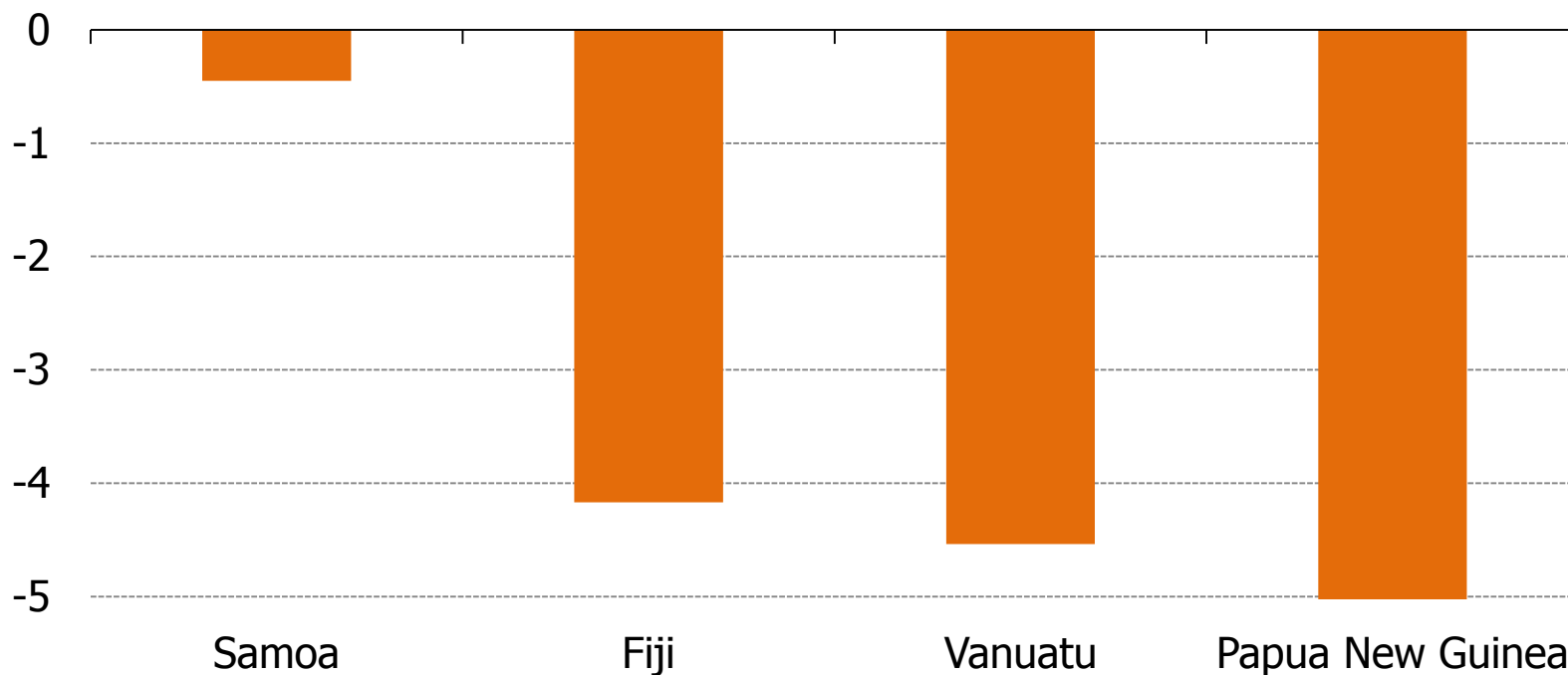
Source: Fund staff calculations.

Note: Not available for Solomon Islands and Tonga.

Credit Pass-Through

(from policy rate to credit growth)

Pacific Islands: Private Credit Long-Run Pass-through
(In percent)



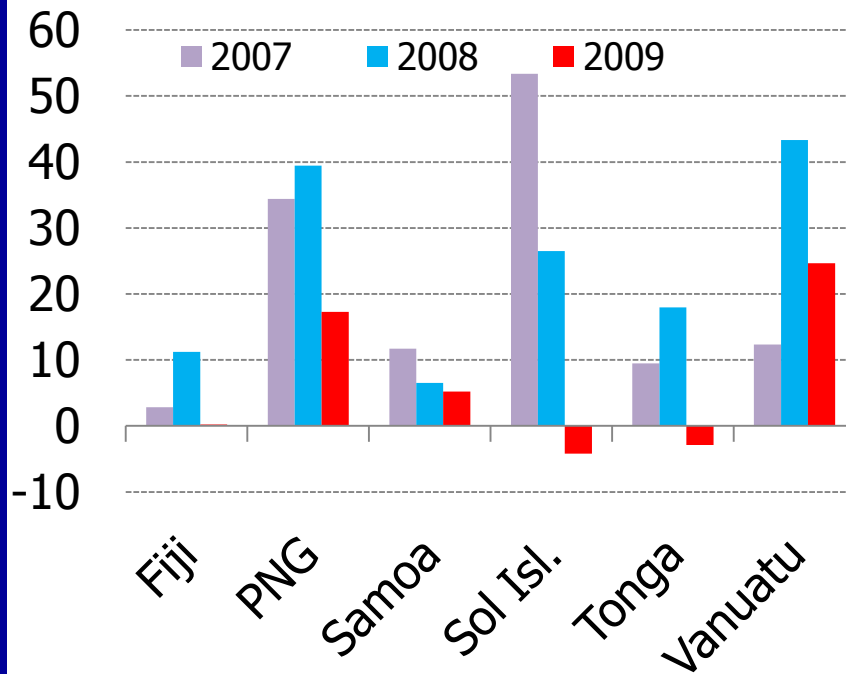
Source: IMF staff estimates.

Crisis Experience

Private Sector Credit

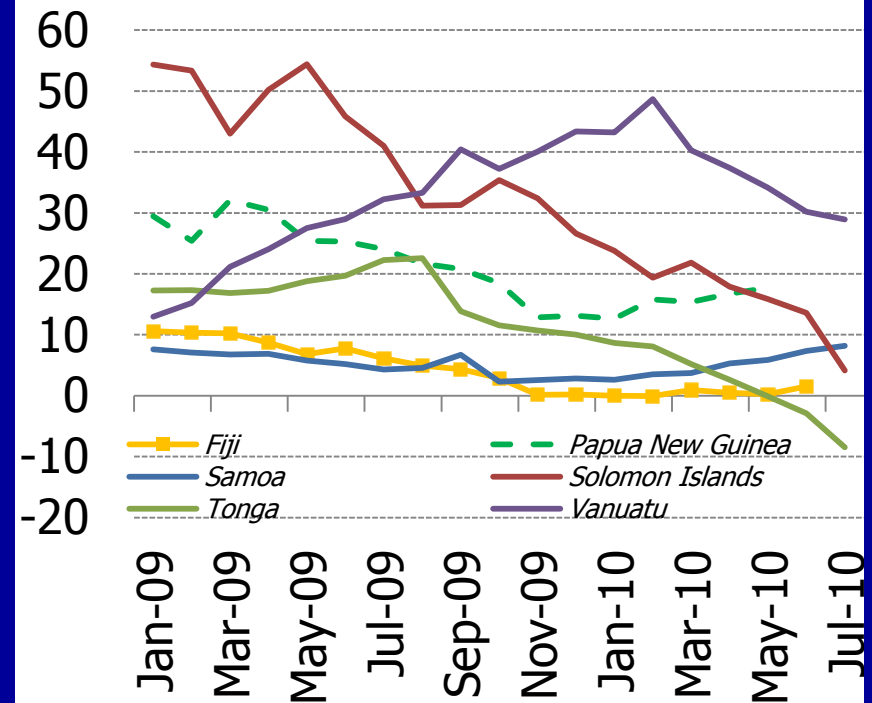
Credit growth slowed sharply in 2009

Private Sector Credit
(Year-on-year Percentage Change)



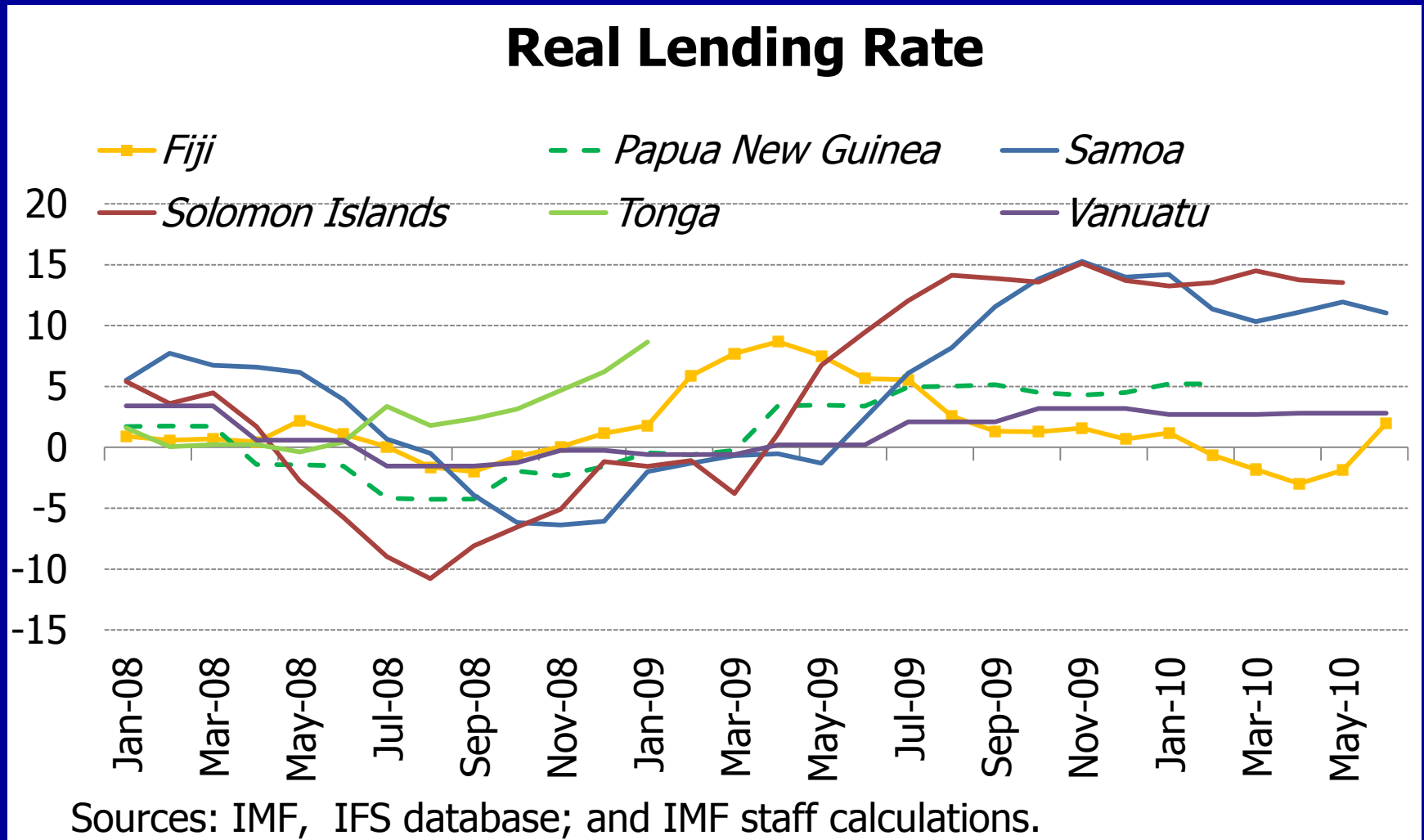
Credit growth has declined further or remains weak in 2010 in most countries

Private Sector Credit
(Year-on-year Percentage Change)



Crisis Experience

Real Lending Rate

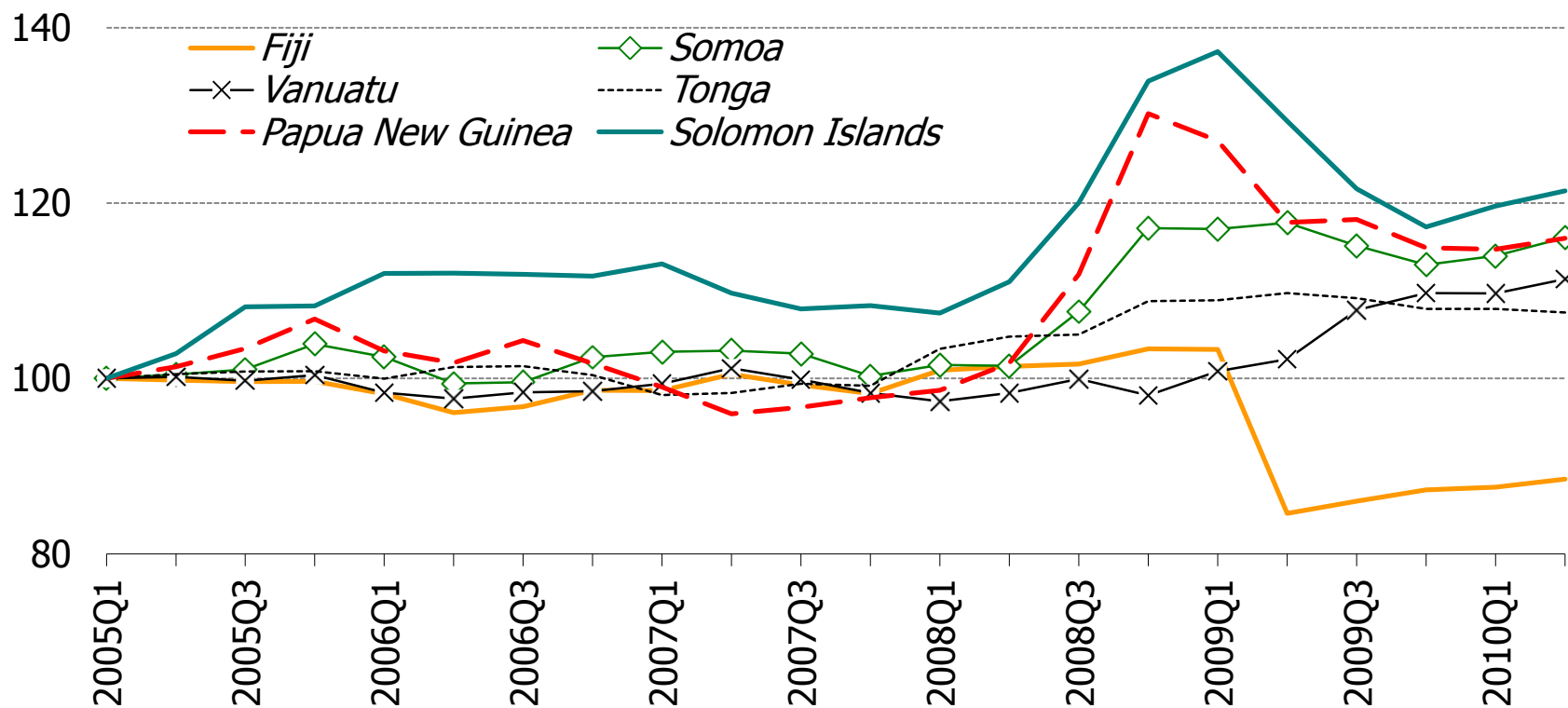


Crisis Experience

Real Effective Exchange Rate

Real Effective Exchange Rate

(2005Q1 = 100)

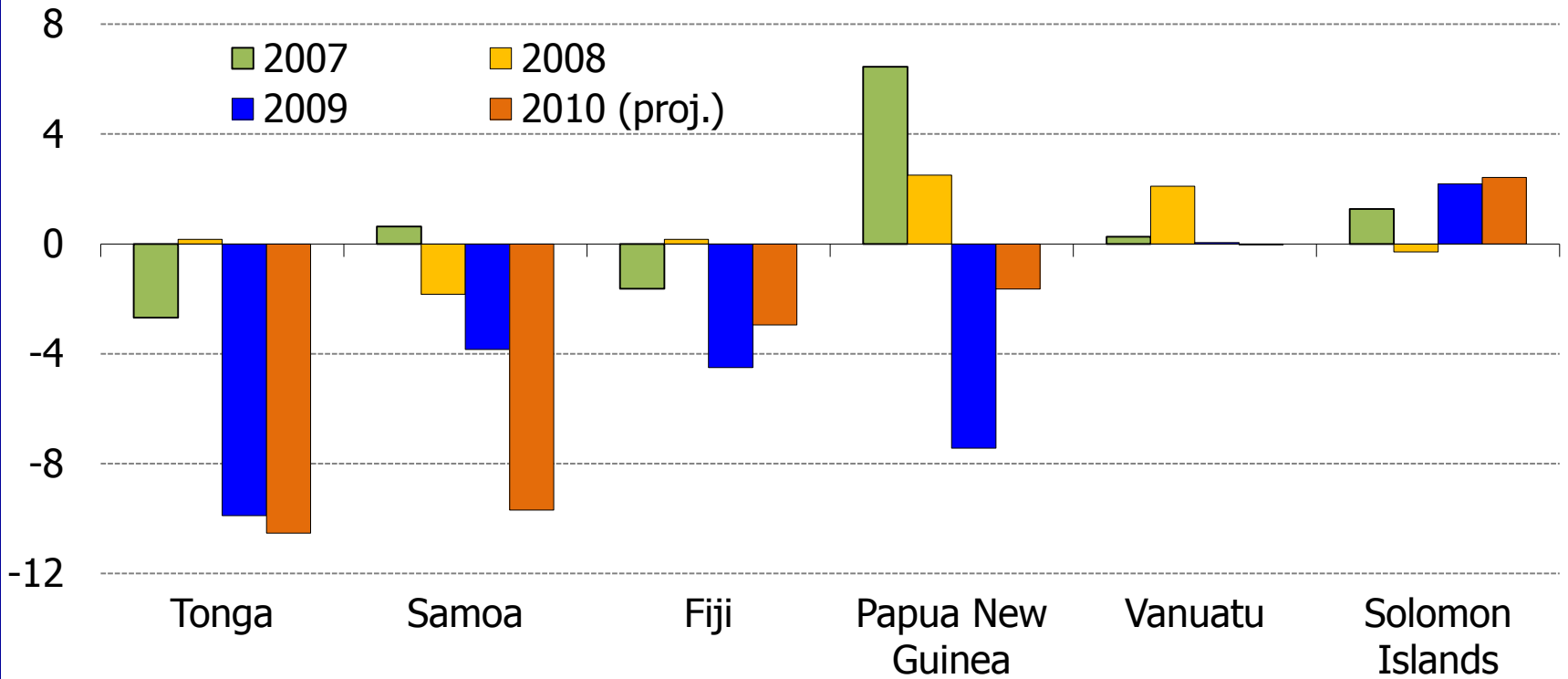


Source: IMF, INS database.

Crisis Experience

Fiscal Balance

Fiscal Balance
(In percent of GDP)

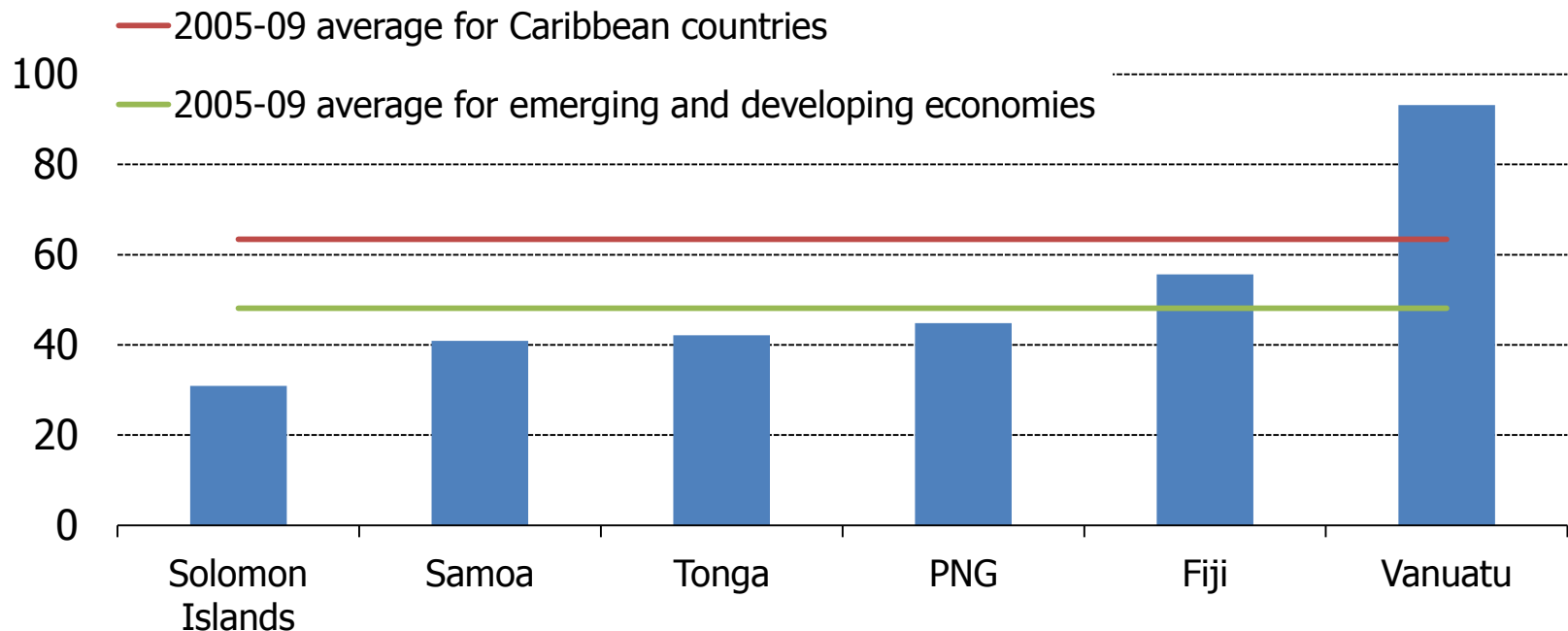


Source: IMF, APDLISC database.

Constraints on Transmission

Broad Money

Pacific Islands: Broad Money, 2005-09 Average ¹
(In percent of GDP)



¹ Caribbean countries include: Bahamas, Dominica, Grenada, Haiti, Jamaica, and Panama. The definition for emerging and developing economies accords with IMF WEO database.

Constraints on Transmission

Banking Concentration

Number of commercial banks in PICs, 2000-09

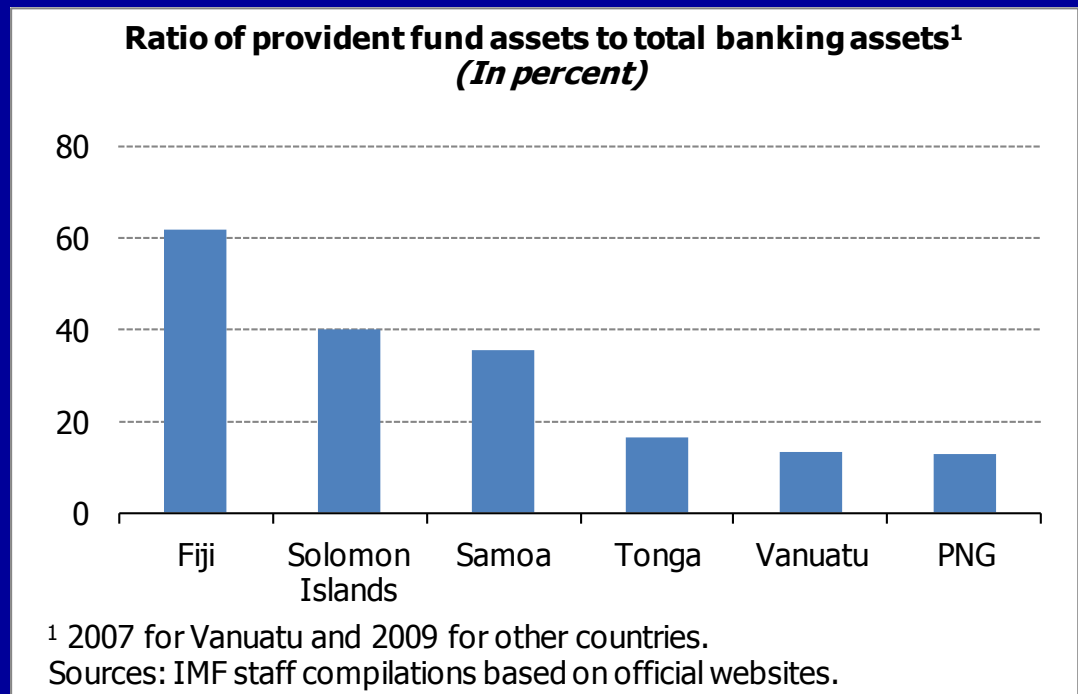
	<u>2000</u>	<u>2005</u>	<u>2009</u>
Solomon Islands	3	3	3
Samoa	3	4	4
Vanuatu	4	3	4
Tonga	3	3	3
Papua New Guinea	6	4	4
Fiji	5	5	5

Sources: Central bank information and IMF staff reports.

Constraints on Transmission

Provident Funds

- Control much liquidity
- Provide significant amounts of credit
- Dampen price signals
- Policy options?



Macroeconomic Policy Coordination

Role of Exchange Rate Policy

- Fixed exchange rate as a nominal anchor
- Fixed rate can still play an important role in macroeconomic adjustment:
 - One-off devaluations
 - A band/corridor around central parity
- Expenditure-switching effects can be powerful to restore external balance
- Flexibility can minimize domestic price adjustment and output losses

Macroeconomic Policy Coordination

Role of fiscal Policy

- Powerful tool to change aggregate demand
- Prudent fiscal policy essential to
 - Maintaining fixed exchange rates
 - Ensuring adequate credit to the private sector
- Fiscal authorities need to coordinate with monetary authorities for liquidity management
- Important for growth and inflation outcomes

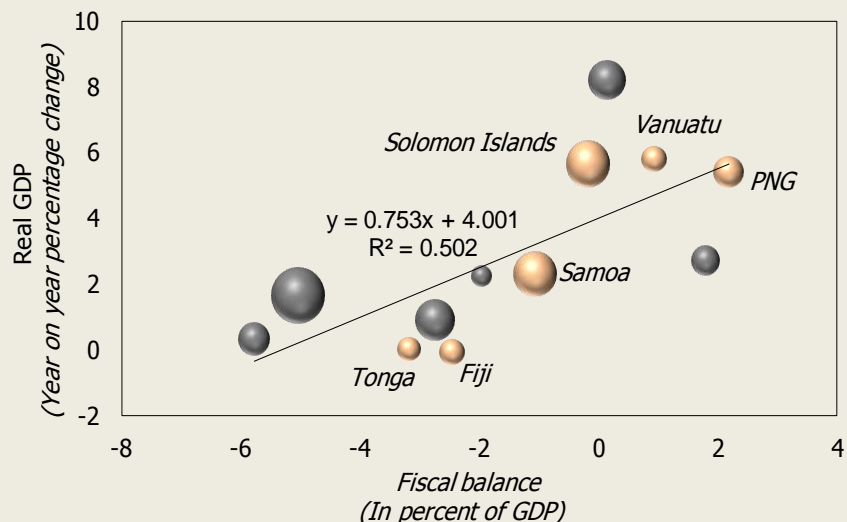
Macroeconomic Policy Coordination

Impact of fiscal Policy on Growth

Smaller deficits are associated with higher GDP growth

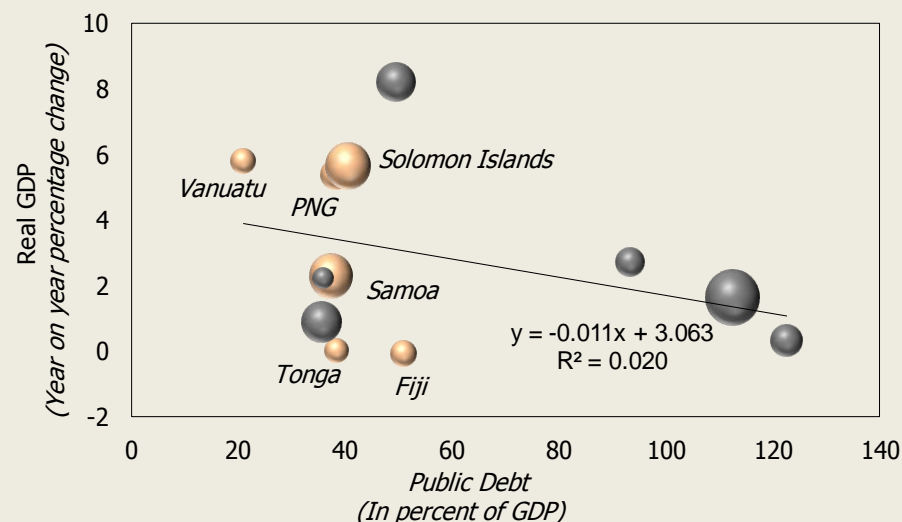
Higher public debt is associated with lower GDP growth

Pacific Islands: Fiscal Balance and GDP Growth



¹ Bubble size indicates standard deviation of Real GDP growth. Black and white bubbles indicate the following Caribbean countries: Bahamas, Dominica, Grenada, Haiti, Jamaica, and Panama.

Pacific Islands: Public Debt and GDP Growth



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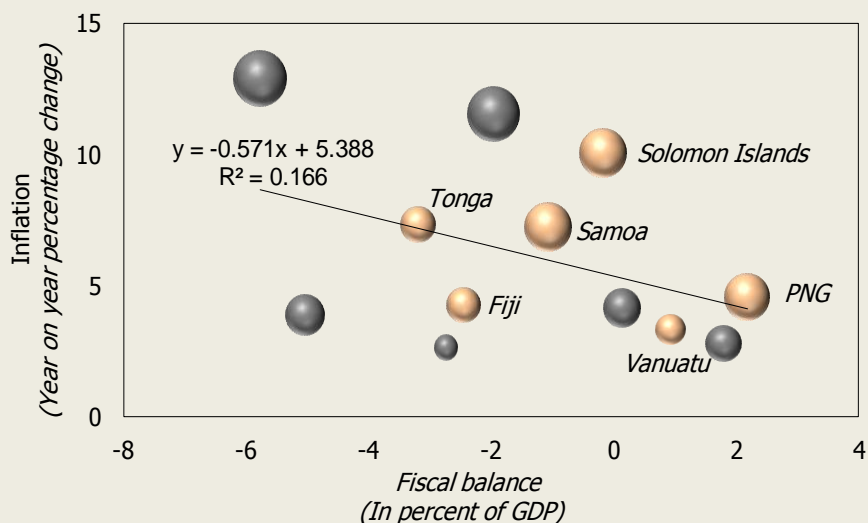
Macroeconomic Policy Coordination

Impact of fiscal Policy on Inflation

Larger fiscal deficits are associated with higher inflation

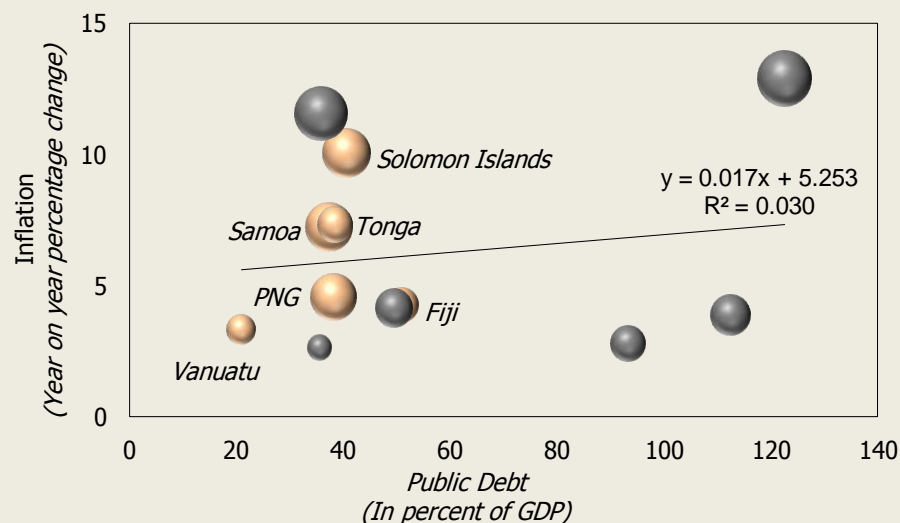
Higher public debt is also associated with higher inflation

Pacific Islands: Fiscal Balance and Inflation



¹ Bubble size indicates standard deviation of inflation. Black and white bubbles indicate the following Caribbean countries: Bahamas, Dominica, Grenada, Haiti, Jamaica, and Panama.

Pacific Islands: Public Debt and Inflation



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Conclusions

- The crisis experience highlights the weaknesses of monetary policy transmission—disconnected and inactive interest rate policy; credit channel important
- Long-run focus should be on financial market development to strengthen policy transmission
- Need to expand the toolkit for macro management in the short run and strengthen policy coordination
- The role of exchange rate policy can be explored
- Prudent fiscal policy is vital for macroeconomic stability and economic growth



Thank You