



*Monetary policy in transition:  
Case for a two-pillar monetary regime*

## **Lecture 3: Policy formulation**

**Ian Nield**

IMF Technical Assistance Office for Lao and Myanmar (IMF-TAOLAM)

IMF-TAOLAM training activities are supported by funding from the Government of Japan

*This presentation is based on the following draft paper*

***The Journey to Inflation Targeting: Easier Said than Done: The Case for Transitional Monetary Arrangements Along the Road,***

*by an IMF Staff Team led by Bernard J. Laurens, and comprising Kelly Eckhold, Darryl King, Abdul Naseer, and Nils Maehle (all MCM), with contributions by Alain Durré (IESEC and CNRS).*

## Overview

- Why are we here today?
- Why formulate policy?
- What is needed?
- Next steps?
- Q&A

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## Why are we here today?

- Monetary stability is a key central bank objective.
- Achieving monetary stability depends on a range of local conditions, including:
  - statutory framework;
  - form of locally accepted “money”;
  - local infrastructure; and
  - development of the financial system.
- Proposed IMF transition framework.

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*“The Central Bank shall, in accordance with its aim, also endeavour to attain the following objectives:*

*(a) to promote monetary stability;*

*(b) to enhance financial system stability;*

*(c) to develop efficient payment and settlements system;*

*(d) to support the general economic policy of the Government conducive to sustained economic development.”*

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## Why formulate policy?

- It helps to know where you are going and why.
- In formulating policy, we take policy path that chooses appropriate tools.
- Formulating policy that is contextually relevant is crucial to achieving the objective.

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# Monetary Policy Formulation

## *Guiding Principles - I*

- Monetary policy is conducted in a changing economic environment involving a degree of uncertainty.
- A forward-looking approach supported by an appropriate analytical capacity at the central bank can help address such uncertainty.

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# Monetary Policy Formulation

## *Guiding Principles - II*

- The form and degree of sophistication of central bank analytical work will depend on the degree of maturity of its economic and research units, the importance of the statistical tool, the profile of its staff, and data quality and coverage.

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# Monetary Policy Formulation

## *Guiding Principles - III*

- The consensus for structuring analytical work in a central bank leads to a distinction between economic analysis and research-oriented economic modeling.
  - Economic analysis: short-term, recurrent analysis ***with a view to determining the stance of monetary policy.***
  - Research-oriented economic modelling: objective is to estimate structural models mostly ***to elaborate policy scenarios in presence of economic shocks.***

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# Monetary Policy Formulation

## *Guiding Principles - IV*

- Over time, enhanced economic analysis may lead to a research function:
  - understand the economic environment, long-term fundamental analyses, regularly testing the stability of the major economic balances;
  - not a substitute for academic research, but complement it;
  - high-quality research enhances credibility

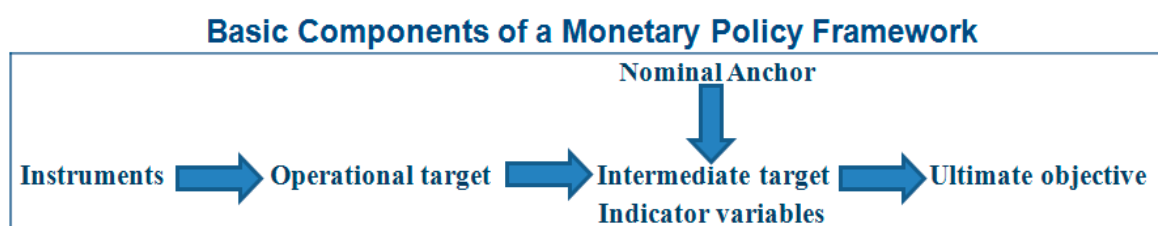
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# Money and monetary analysis

- Monetary analysis is relevant for:
  - monetary policy; and
  - financial stability.
- Understanding the correlation between monetary aggregates and inflation dynamics must retain a role in economic analysis surrounding monetary policy.
- Status of money in the monetary policy strategy depends on the degree of financial markets sophistication.

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## Choosing a framework - I



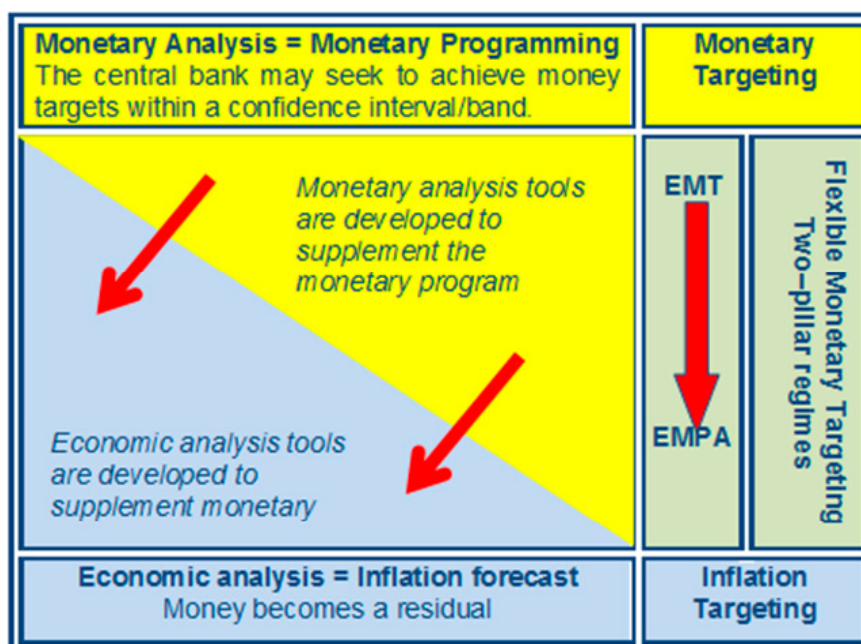
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# Choosing a framework - II

- Instruments and targets:
  - i. aligned with strength of transmission channels; and
  - ii. supporting the transmission channels.
- Financial markets: monetary frameworks “friendly” to monetary policy transmission.
- Clear roles assigned to key macroeconomic variables.
- Effective comms. – anchor expectations.

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## The two policy pillars



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# Key building blocks

- Monetary policy formation needs to be appropriate to where the central bank is in the continuum between “monetary analysis” and “economic analysis”.
- The tools and instruments also need to be relevant.
- Underlying each of these is an appropriate data and analytic capacity.

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# What about you?

- Critically analyse where your country sits in this space.
- Where are you heading to over the next 5, 10 years?
- Are you ready to start to transition?
- Do you want to change?
- What is appropriate?

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So what?

