Recommendations for a New Framework on Monetary Policy

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Reasoning:

- Limited tools by central bank over control of financial markets
- Accelerating trade and financial liberalization process create trade and financial imbalances

1.Limitations of current monetary policy

- On Interest rate, foreign exchange and financial liberalization
- On Money market and capital market
- On inflation and recession

2. Need of a new monetary policy

- Inflation targeting is not effective for preventing or recovering from economic recession and might negative impact on the economy
- Future economic crisis will be the result of international liquidity management and can not be prevented , only lessened.
- Management of liquidity and capital structure to minimize the impact of international financial volatility will be the key policy

An opinion on ‘Inflation Targeting’

- Inflation targeting replaced money-supply targeting to manage inflation
- Inflation targeting hardly works in deflationary economy, so not suitable for period of economic recession
- Though effective in bringing inflation rate down, the downside risks might be too costly.
- Fact: Inflation in emerging markets is mostly ‘imported’ through increases in energy and commodity prices.
- Raising interest rate whenever price level exceeds the target level can reduce aggregate demand and falling domestic prices, resulting in economic slowdown and unemployment
- Fact: the weakened economy and higher unemployment does not have much impact on ‘imported’ inflation

3. Redesigning new monetary policy

The US economic structure

- Imbalance between the financial and real economy
  - In USA:
  - Financial sector dominates GDP proportions (14 to 20%) and dominates the world economy
  - Manufacturing decreases from 27 to 11%
  - Trade decrease from 16 to 12%
  - Debt driven economy
- Wealth and income imbalance
  - Increasing wealth and income inequality
  - Real wages not rising with productivity
- Current account imbalance
  - Prolonged trade deficits

"Economic system becomes dysfunctional when its components are out of balance."

Structural changes in Thailand

- Limits to export-led growth induced by EU and US
- Increasing Asian ‘domestic’ markets without debt creation.
- Right mix of investments to reap greater returns
- Short term capital flows dominate over trade and direct investment flows

Free capital flows can hurt trade !!!

The world liquidity

- Financial globalization and liquidity expansion
- Massive liquidity can be created without inflation
- The present monetary control measures were unable to contain liquidity expansion

Factors which accelerate the process of liquidity expansion

- Global imbalances
- The debt recycle mechanism: Trade and capital flows from demand for US dollars
- Disinflation environment driving up asset prices
- The US saving behavior
- New financial innovations to provide unlimited liquidity

Types of liquidity buildup

- Power money – M1
- Broad money – M2
- Securitized debts
- Derivatives

4. Recommendations

- Minimize impact of international liquidity movement
- Use neutralized interest rate policy – a modified form of inflation targeting
- Minimize risk of exchange rate volatility from capital flows
- Regulate movement of hedge funds with ‘Tobin tax’ and compliance measures
- Establish ‘FSA’ type institution to synchronize liquidity management and management of capital structure

4.1 Minimize impact of international liquidity movement

- Encourage FDI
- Discourage strong speculative motives
- Balance trade and financial liberalization process
- Lessening foreign exchange volatility

4.2 Neutralized interest rate policy – a new form of inflation targeting

- Be aware of global rebalancing process
- Managed float exchange rate and neutralization of interest rate
- Lessening impact of world energy and commodity prices

4.3 Minimize risk of exchange rate volatility from capital flows

- Global capital flows and investors' appetite
- Management of capital outflows
- Management of capital inflows
- Management of foreign exchange reserve

4.4 Regulate movement of hedge funds with ‘Tobin tax’ and compliance measures

- Hedge funds and global capital flows
- Regulating the hedge funds
- Tobin tax
- Compliance measures

4.5 Establish ‘FSA’ type institution to manage liquidity level and management of capital structure

- Coordination of regulatory authorities
- Interdependence of financial institutions
- Independence of regulatory authorities
- Need of financial clusters
- Formation of FSA type institution for collaborations

The End