

# Re-Thinking Monetary Policy Objectives: Why Mess with Success?

**Comment**

**Jun Il Kim**

Deputy Governor  
Bank of Korea



# Key questions for discussion

- Should EM central banks under IT care about financial stability—or, more broadly, something other than inflation (and output)?
- Should EM central banks care about financial stability or the exchange rate *in their conduct of monetary policy*?
- If so, how and to what extent?
- How to measure “success”?
- Apparent success of IT by EM central banks of Asia in the 2000s: good policy or good luck?

# Several useful observations

- After the GFC, the role of central bank for financial stability has been strengthened in 15 countries through legislation (including broader CB mandates)
- 27 countries have adopted IT since 1990; no one has thus far abandoned it
- Most EM central banks participated in BIS survey said “yes” for the importance of the exchange rate in their conduct of monetary policy
- Many EMEs—Asian EMEs in particular—were an innocent bystander of the GFC

# Financial stability as a mandate for CB

- Financial cycle of longer duration than business cycle
- Financial stability matters for price stability (e.g., deflation in Japan, post-GFC global disinflation/deflation)
- Price stability does not necessarily ensure financial stability (e.g., Great Moderation followed by GFC and Great Recession)
- Lean vs Clean: Economic cost of (ex post) clean could be far higher than efficiency cost of (ex ante) lean

# Financial stability as an objective of MP

- CBs may address financial stability concerns using macro-prudential policies (MPPs)—and not necessarily by using monetary policy (MP)
- MPPs may be useful to address financial imbalances of isolated nature (e.g., housing market boom) but cannot fill in all cracks
- MP may be too blunt a tool for financial stability but can address every cracks
- As such, corner solution (dichotomy) is less likely to be an optimal solution

# How to incorporate financial stability in MP

- Further study is certainly needed to make financial stability an operational concept for monetary policy
- Several financial indicators have been suggested as an intermediate target of monetary policy (e.g., credit spreads, domestic credit growth)
- In all likelihood, however, best financial stability indicator(s) for monetary policy may vary over time
- Evolving nature would pose challenge for MP credibility and effectiveness

# Apparent Success of IT for Asian EMEs

- Sample period overlaps with Great Moderation—good luck as well as good policy
- Evidence suggestive but not robust enough to tell if success was obtained due to greater focus on  $\pi$  and  $y$
- Success defined over ( $\pi$  and  $y$ ) may not offer right guidance on whether to add financial stability to the objective of MP
- Asia's success has yet to be tested for the period of financial stress or crisis.

# Conclusion

- Set the stage for useful intellectual discussion (from theoretical level to empirical level) on important but highly debatable policy issue
- Evidence is suggestive for “not mess with success” but too preliminary for firm conclusion
- Operationalizing financial stability concept in the context of MP remains elusive at present and may require more research
- More case studies on EMEs (which had adopted IT but also experienced significant financial stress) could shed light on the issue



THANK YOU!



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