MONETARY POLICY AND THEORY

AGENDA

- Central bank from global perspectives
  - Federal reserve system
  - The ECB
  - Bank of Thailand

GLOBAL PERSPECTIVES OF CENTRAL BANK: FEDERAL RESERVE SYSTEM

- **The First/second Bank of the United States: 1791-1811 / 1816 – 1836: national banker.**

- **Resistance to establishment of a central bank**
  - Fear of centralized power
  - Distrust of moneyed interests

GLOBAL PERSPECTIVES OF CENTRAL BANK: FEDERAL RESERVE SYSTEM

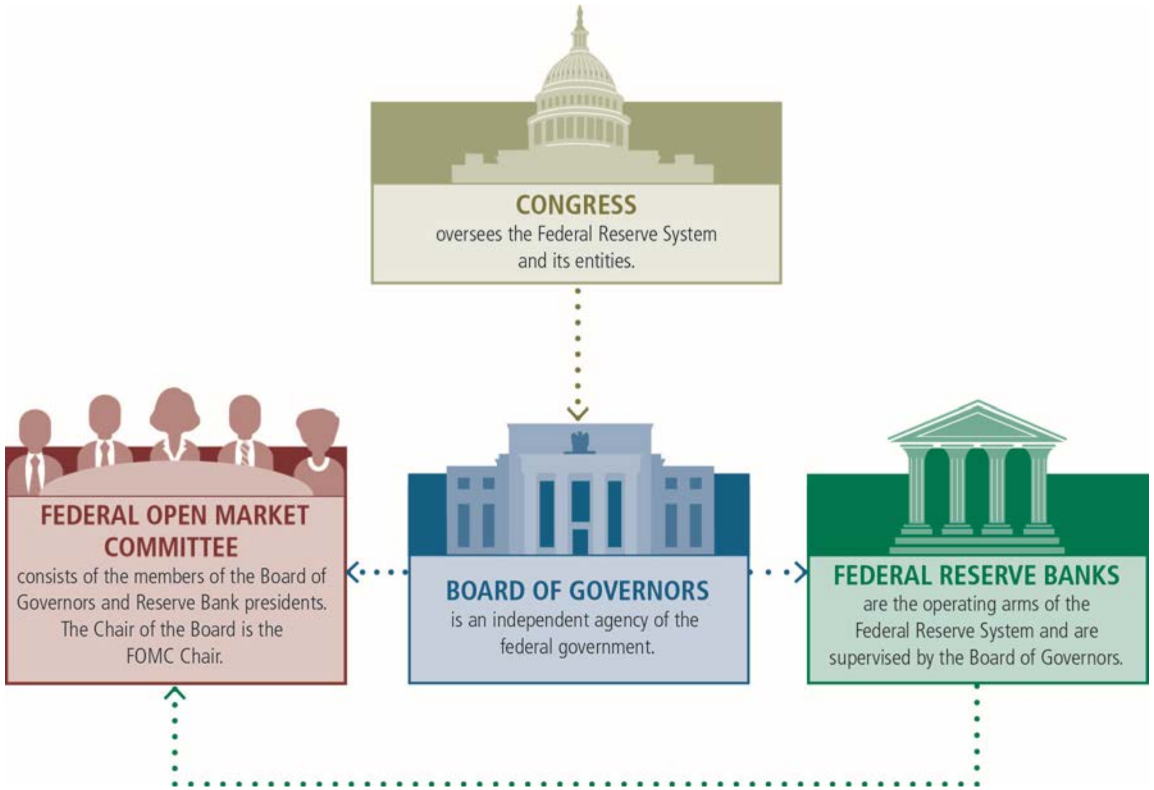
- **No lender of last resort**
  - Nationwide bank panics on a regular basis. (Calomaris and Gorton: 1991: Origin of banking panics)
  - Panic of 1907 so severe that the public was convinced a central bank was needed
- **Federal Reserve Act of 1913**
  - Elaborate system of checks and balances
  - Decentralized

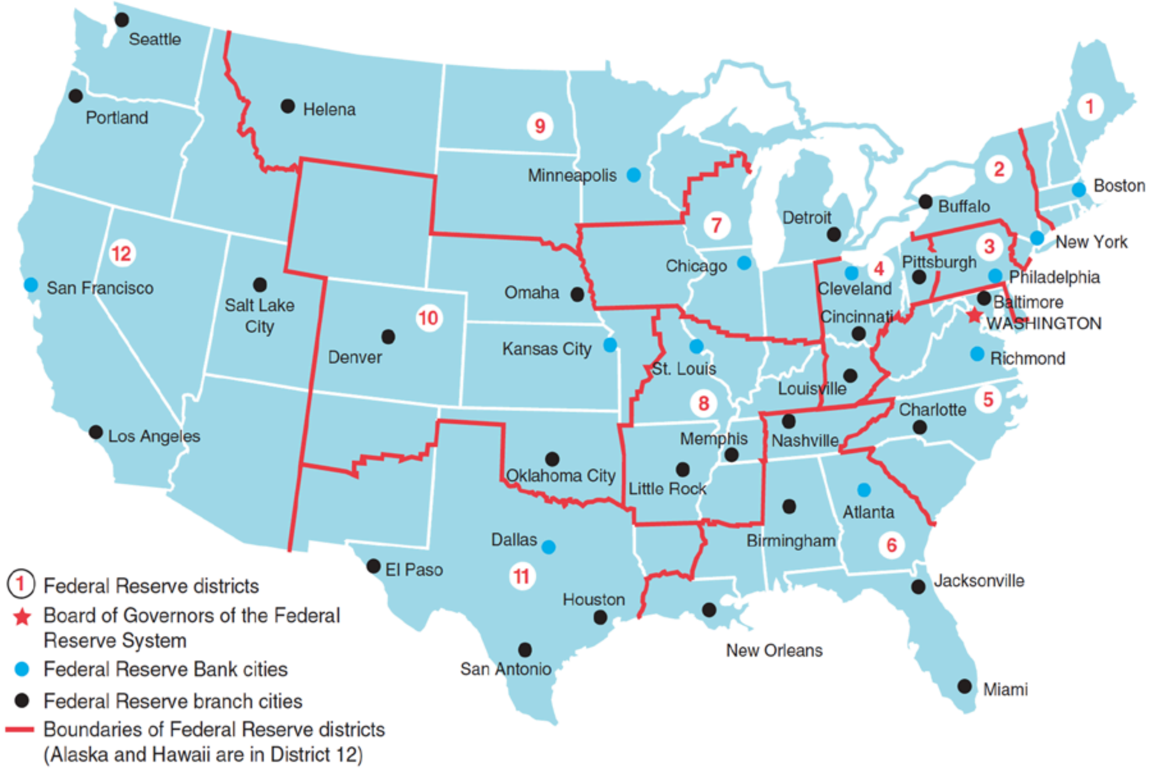
GLOBAL PERSPECTIVES OF CENTRAL BANK: FEDERAL RESERVE SYSTEM

- The writers of the Federal Reserve Act wanted to **diffuse power** along regional lines, between the private sector and the government, and among bankers, business people, and the public.
- This initial diffusion of power has resulted in the evolution of the Federal Reserve System to include the following entities:
  - The Federal Reserve banks – 12 Districts
  - The Board of Governors of the Federal Reserve System
  - The Federal Open Market Committee (FOMC)

GLOBAL PERSPECTIVES OF CENTRAL BANK: FEDERAL RESERVE SYSTEM

- Quasi-public institution owned by private commercial banks in the district that are members of the Fed system





CENTRAL BANK MANDATES: FEDERAL RESERVE

GLOBAL PERSPECTIVES OF CENTRAL BANK: FEDERAL RESERVE SYSTEM

- Member banks elect six directors for each district; three more are appointed by the Board of Governors
  - Three A directors are professional bankers
  - Three B directors are prominent leaders from industry, labor, agriculture, or consumer sector
  - Three C directors appointed by the Board of Governors
    are not allowed to be officers, employees, or stockholders of banks
  - Designed to reflect all constituencies of the public
- Nine directors appoint the president of the bank; subject to approval by Board of Governors

GLOBAL PERSPECTIVES OF CENTRAL BANK: FEDERAL RESERVE SYSTEM

- Function of Federal Reserve Banks
  - Clear checks
  - Issue new currency
  - Withdraw damaged currency from circulation
  - Administer and make discount loans to banks in their districts
  - Bank licensing / Merger & Acquisition approval / Supervision
  - Collect data on local business conditions

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

- Seven members headquartered in Washington, D.C.
- Appointed by the president and confirmed by the Senate
- 14-year non-renewable term
- Required to come from different districts
- Chairman is chosen from the governors and serves four-year term

FEDERAL OPEN MARKET COMMITTEE (FOMC)

- Meets eight times a year
- Consists of seven members of the Board of Governors, the president of the Federal Reserve Bank of New York and the presidents of four other Federal Reserve banks
- Chairman of the Board of Governors is also chair of FOMC
- Issues directives to the trading desk at the Federal Reserve Bank of New York

HOW INDEPENDENT IS THE FED?

- Instrument and goal independence.
- Independent revenue
- Fed's structure is written by Congress, and is subject to change at any time.
- Presidential influence
  - Influence on Congress
  - Appoints members
  - Appoints chairman although terms are not concurrent

SHOULD THE FED BE INDEPENDENT?

- **The Case for Independence**
  - The strongest argument for an independent central bank rests on the view that subjecting it to more political pressures would impart an inflationary bias to monetary policy.
- **The Case Against Independence**
  - Proponents of a central bank under the control of the president or parliament argue that it is undemocratic to have monetary policy (which affects almost everyone in the economy) controlled by an elite group that is responsible to no one.

THE CASE FOR INDEPENDENCE

- Political pressure would impart an inflationary bias to monetary policy
- Political business cycle
- Could be used to facilitate financing of large budget deficits: accommodation
- Too important to leave to politicians—the principal-agent problem is worse for politicians

THE CASE AGAINST INDEPENDENCE

- Undemocratic
- Unaccountable
- Difficult to coordinate fiscal and monetary policy
- Has not used its independence successfully

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STRUCTURE AND INDEPENDENCE OF THE EUROPEAN CENTRAL BANK

- January 1999: Start-up of the European Central Bank (ECB) and European System of Central Banks (ESCB). These conduct monetary policy for countries that are members of the European.

- Patterned after the Deutsche Bundesbank, (the German central bank); the central banks for each country have a similar role to that of the Lander Banks.

STRUCTURE AND INDEPENDENCE OF THE EUROPEAN CENTRAL BANK

- Monetary Union Central banks from each country play similar role as Fed banks
- ESCB encompasses the ECB and the National Central Banks of the 28 EU member states (including the 2013 addition of Croatia as the 28th EU member state).
- The Euro system comprises of the ECB and the NCBs of only the 19 countries that have adopted the euro.
- Governing Council

GOVERNING COUNCIL

- Monthly meetings at ECB in Frankfurt, Germany
- Six Executive Board members, governors of 19 National Central Banks
- Operates by consensus
- ECB announces the target rate and takes questions from the media
- To stay at a manageable size as new countries join, the Governing Council will be on a system of rotation.

HOW INDEPENDENT IS THE ECB?

- Most independent in the world
- Members of the Executive Board have long terms
- Determines own budget
- Less goal independent
  - Price stability
- Charter cannot by changed by legislation; only by revision of the Maastricht Treaty

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THE BANK OF THAILAND

- Established in 1942
- Has undergone several changes – latest amended version was made in 2017.
- Key mandates:
  - Monetary policy conduct
  - Financial supervision
  - Payment system

BANK OF THAILAND BOARD

- Under the act, there are five important entities :
  - Bank of Thailand board
  - Monetary policy committee (MPC)
  - Financial institutions policy committee (FIPC)
  - Payment systems committee (PSC)
  - The Bank of Thailand Audit Committee (AC)

BANK OF THAILAND BOARD

- Administrate general issues.
- But, not into the area of three functions.
- Total of 12 members: Chairman (1), BOT governor and deputy (4), Officers in some other key government institutions (2), appointed by Ministry of finance (5)

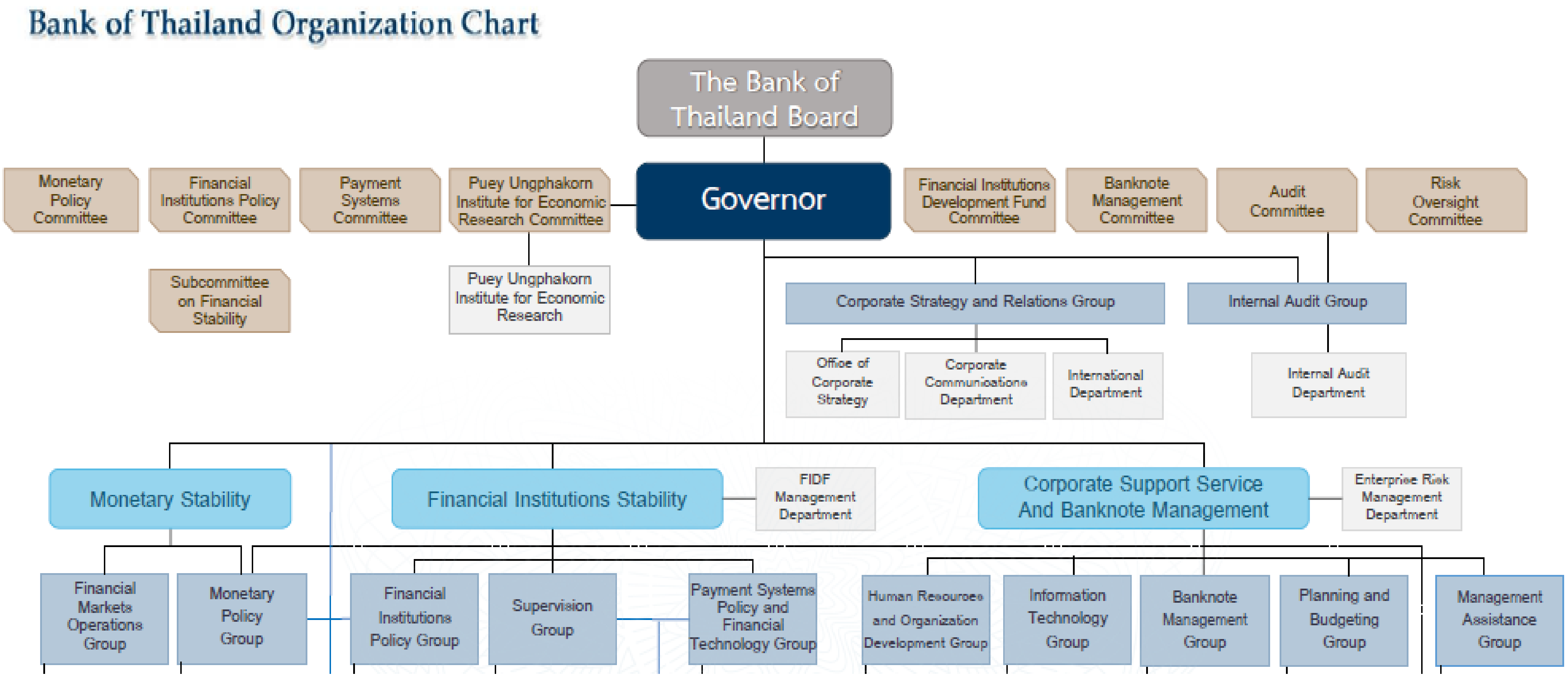
MONETARY POLICY COMMITTEE

- Responsible for setting the monetary policy *stance (direction)*.
- MPC works closely with the staff of the Bank of Thailand in monitoring internal and external economic conditions.
- The Monetary Policy Committee is comprised of 3 internal member and 4 external members.
- Subjected to the approval of the Cabinet, MPC must propose plans/targets to the ministry of finance at the year end.

BANK OF GOVERNOR

- Selection and Nomination by Ministry of finance
- 7 Selection committees appointed by Ministry of finance
- Final decision is made by Ministry of finance.

STRUCTURE OF THE BANK OF THAILAND



MONETARY POLICY CONDUCT

- Fixed exchange rate until 1997; abandoned on July 1997
- Controlling money growth afterwards
- Began implementing the so called "Inflation targeting approach" in 2000.
- Using core inflation as a target until 2015; switch to headline inflation