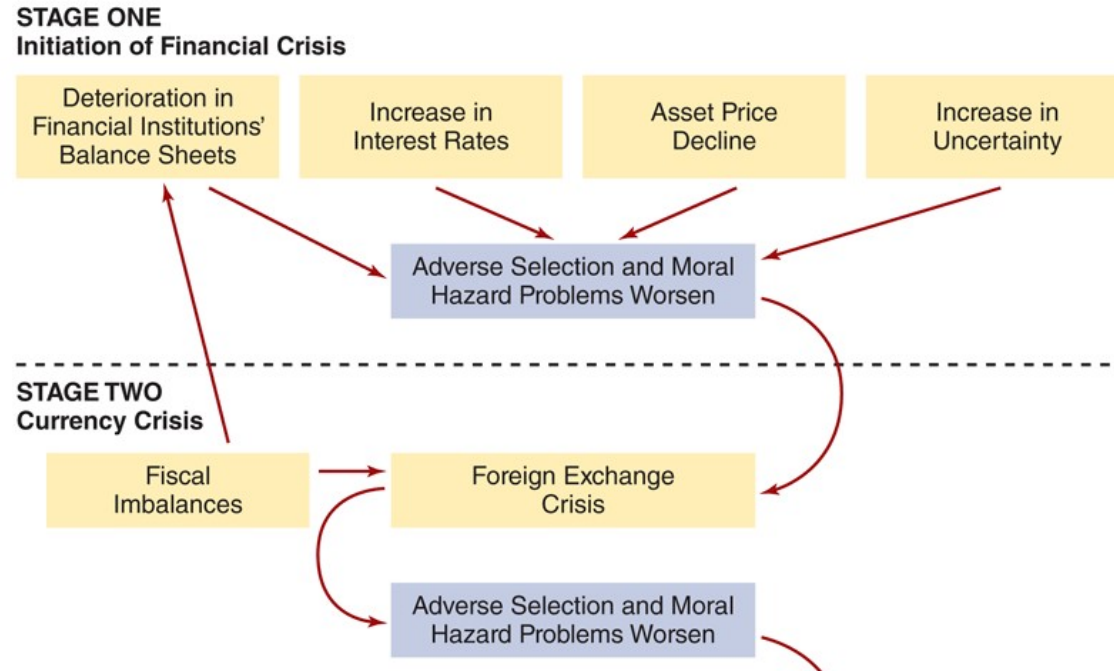
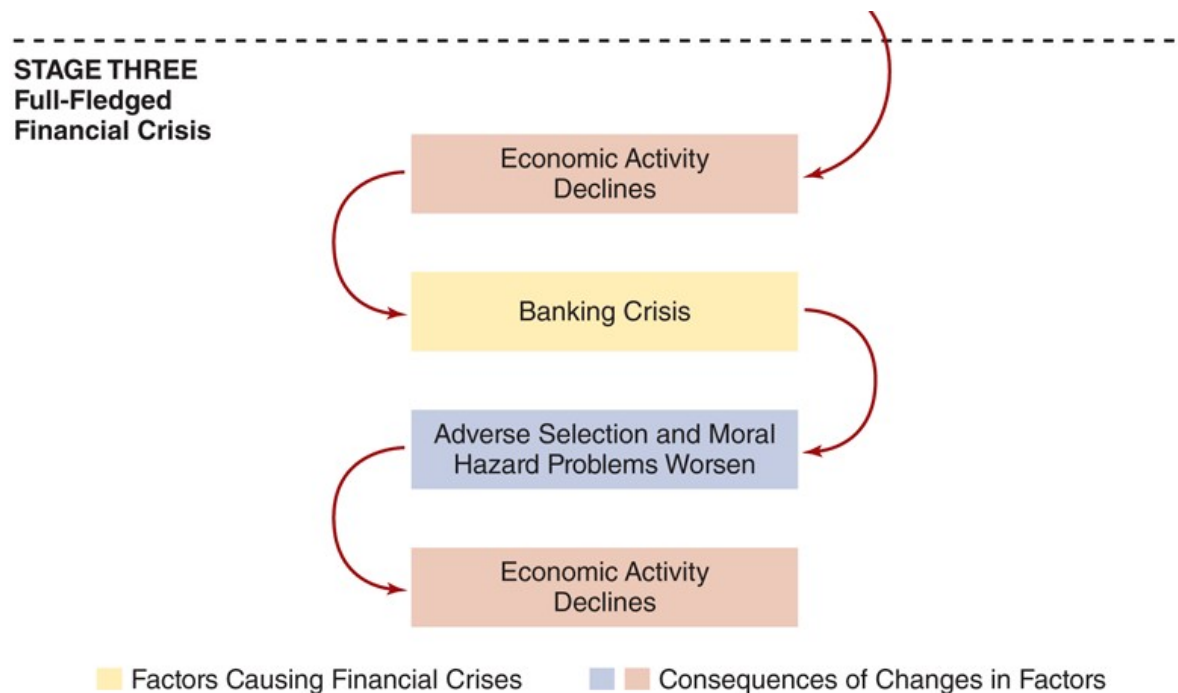


CONTINUE FROM PREVIOUS LECTURE

EMERGING MARKET FINANCIAL CRISIS: SEQUENCE OF EVENTS (A)



EMERGING MARKET FINANCIAL CRISIS: SEQUENCE OF EVENTS (B)



STAGE ONE: INITIATION

Financial crises in emerging market countries develop along two basic paths:

- **Credit Boom and Bust:**

Liberalization/Innovation → **weak credit culture and capital inflows** → credit boom → risky lending → high loan losses → **bank balance sheets deteriorate** → lending cut (more severe here since the rest of the economy is not as developed) → economy contracts

- **Severe Fiscal Imbalances:**

Large fiscal deficit → banks forced to buy gov't bonds → confidence falls → gov't bonds price decline → **bank balance sheets deteriorate** → lending cut → economy contracts

- **Other factors:** Asset price decline, a rise in uncertainty, a rise in external interest rates

- **All factors inducing capital outflows/lower confidence in the currency**

STAGE TWO: CURRENCY CRISIS

A speculative attack in the FX markets

- Bets on the depreciation of the currency of the emerging market
- Oversupply of local currency (**Mass sell-offs of currency**)
→ value of the currency falls → **rundown of int' reserves** →
currency crisis

Large fiscal imbalance

- Investors suspect inability to repay the loans
- Mass sell-offs of gov't debts → **Mass sell-offs of currency**
→ A speculative attack on the currency

STAGE THREE: FULL FINANCIAL CRISIS

Currency crisis → currency devaluation

Devaluation → foreign-currency denominated debt burdens increase → HH/Firms' balance sheets deteriorate → Banks' balance sheets deteriorate

→ Banking Crisis

→ Economy contracts further

CASE: FINANCIAL CRISES IN EMERGING MARKET COUNTRIES

South Korea removed FI regulations, resulting in a lending boom.

Growth close to 20% per year!

But, loan losses mounted, and bank balance sheets deteriorated.

CASE: FINANCIAL CRISES IN EMERGING MARKET COUNTRIES

Large, family-owned conglomerates, known as **chaebols**, accounted for nearly 50% of GDP. **Borrowed excessively** during boom.

Were never very profitable, but considered too-big-to-fail.

Chaebols even encouraged liberalization.

CASE: FINANCIAL CRISES IN EMERGING MARKET COUNTRIES

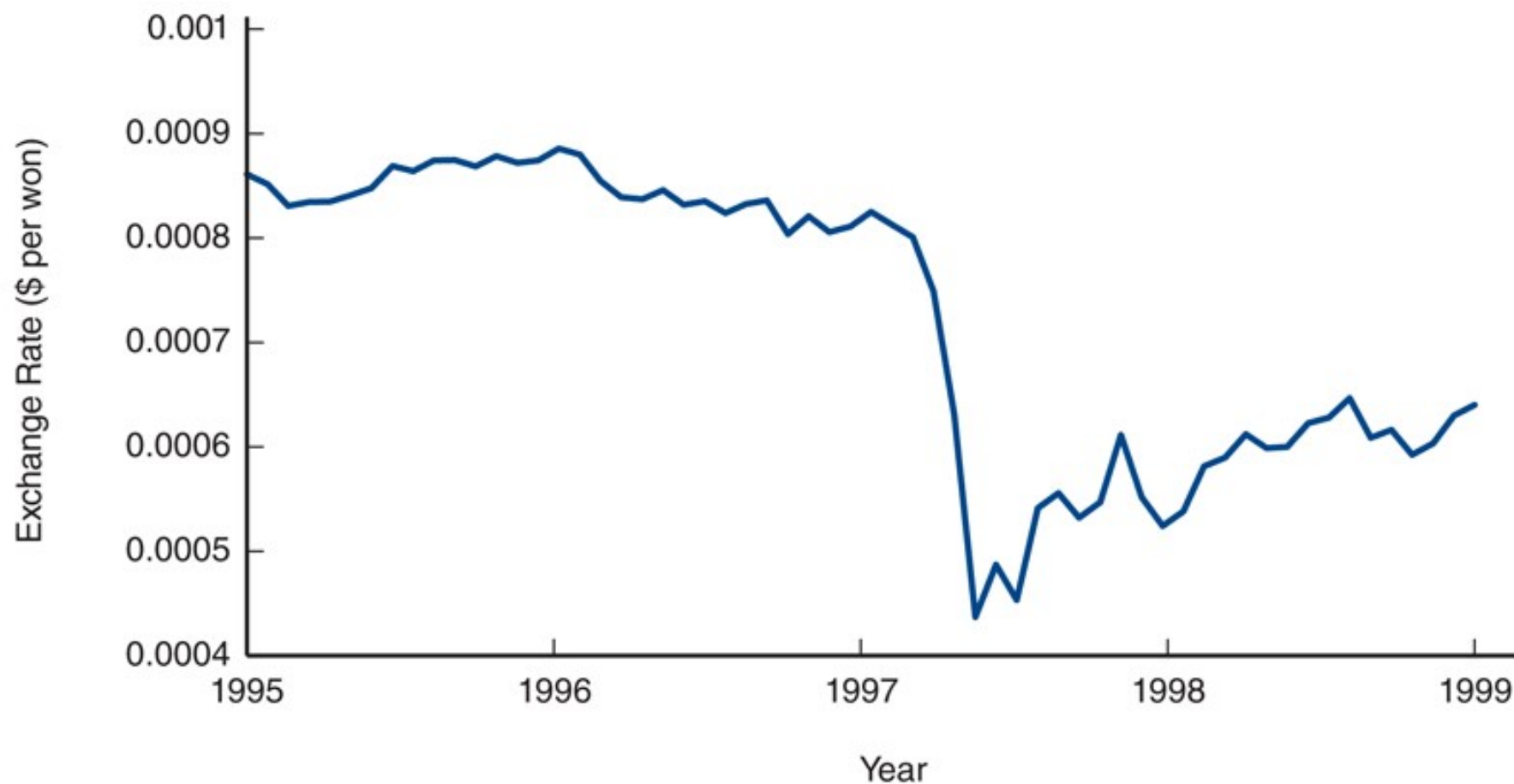
Expanded short-term foreign borrowing (highly mobile) but restricted long-term foreign lending. Perfect recipe for disaster. (**Maturity mismatch**)

Merchant banks appeared, which had little or no regulation.

Increased uncertainty leads to a stock market decline.

CASE: FINANCIAL CRISES IN EMERGING MARKET COUNTRIES

Figure 25.6 Value of South Korean Currency, 1995–1999



Source: International Monetary Fund. *International Financial Statistics*. www.imfstatistics.org/imf/.

CASE: FINANCIAL CRISES IN EMERGING MARKET COUNTRIES

Erosion of won nearly doubles foreign-denominated debt on bank balance sheets.

Banks paid foreign debt, but unable to collect on domestic loans. Lending curtailed.

Economic activity takes a severe fall.

CASE: FINANCIAL CRISES IN EMERGING MARKET COUNTRIES

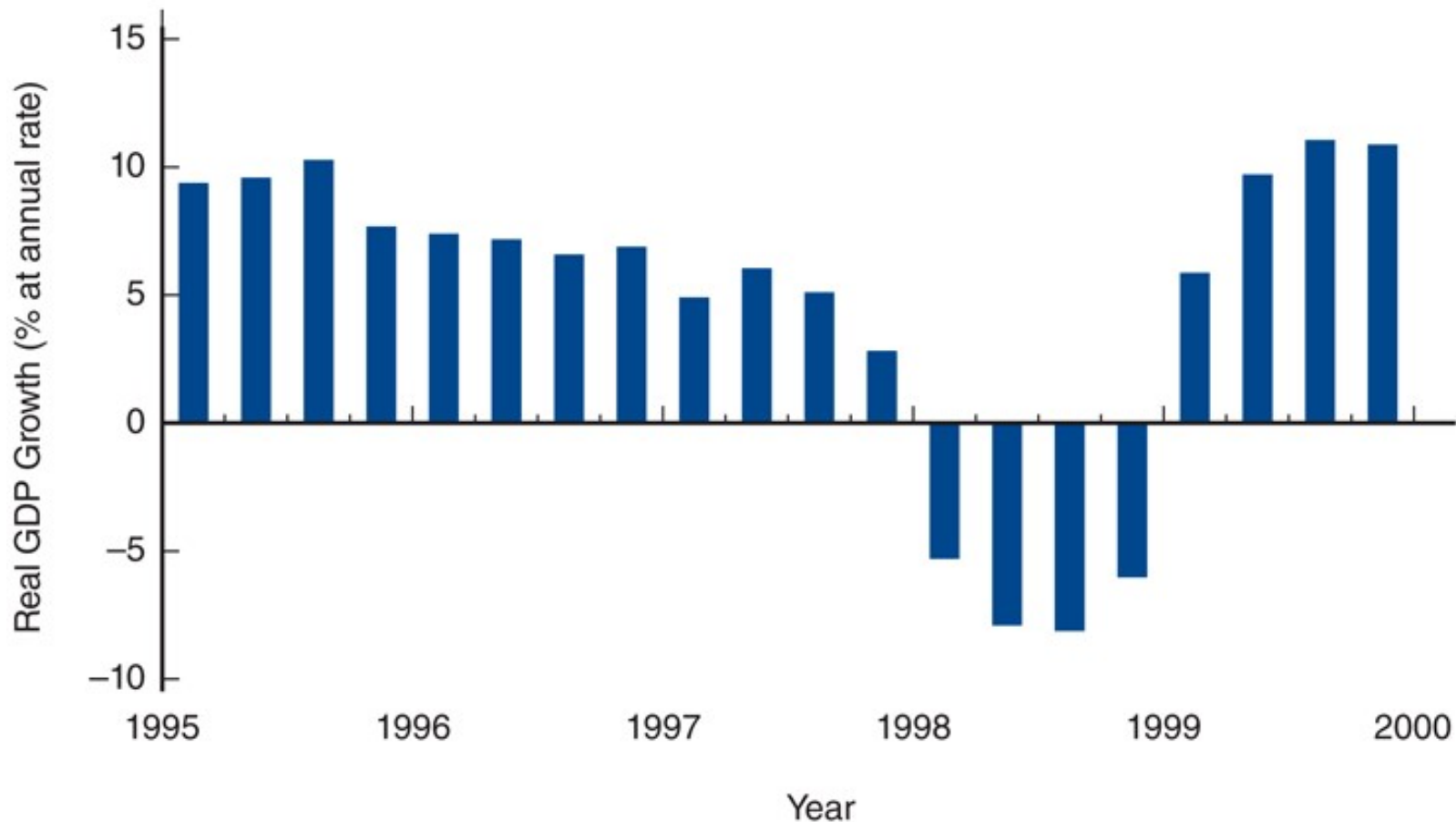
In 1998, government implements reforms to restore confidence.

Poor in South Korea grew from 6m to 10, divorce rates jumped, crime jumped ...

But, the recovery was in sight.

CASE: FINANCIAL CRISES IN EMERGING MARKET COUNTRIES

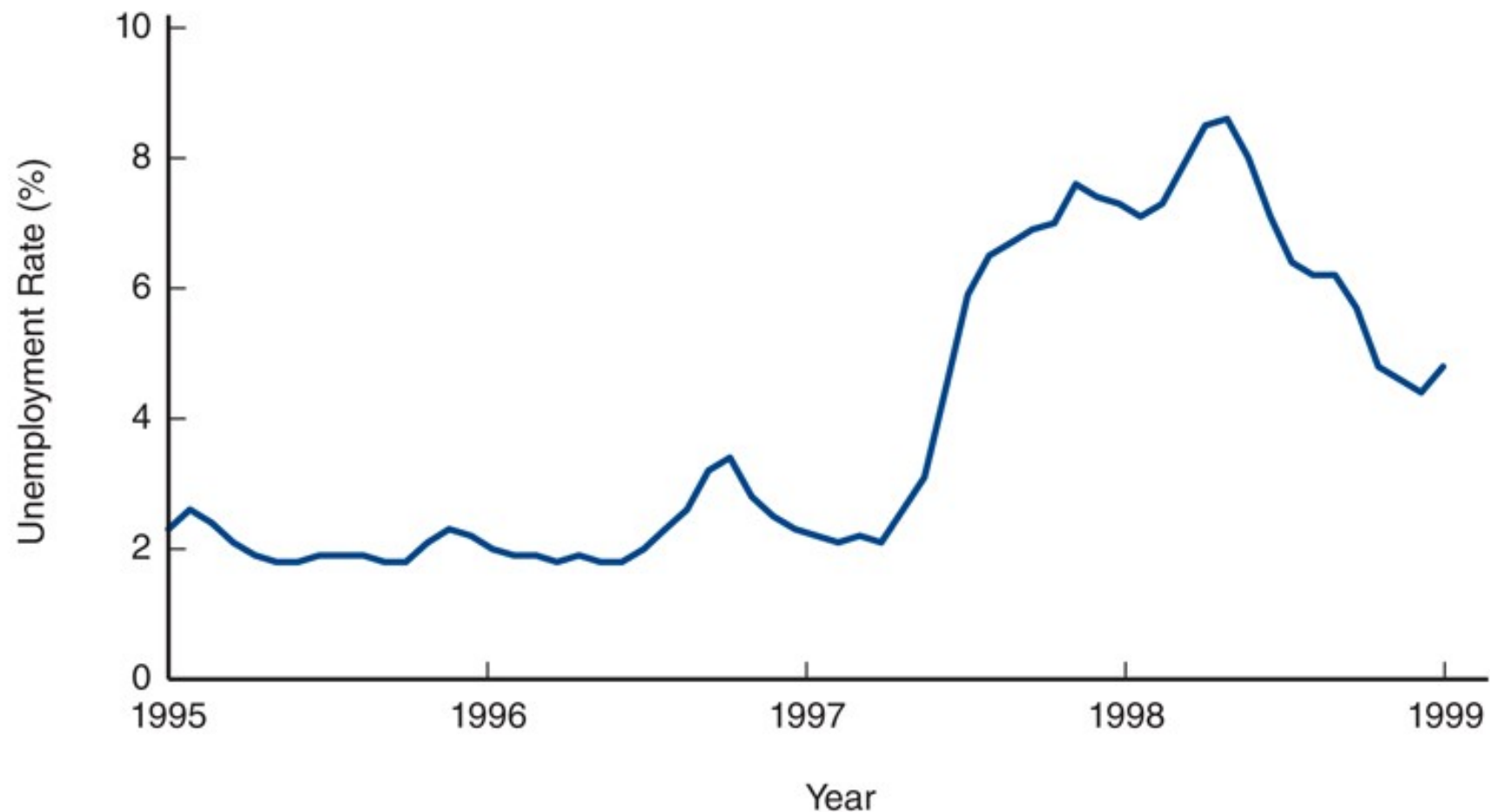
Figure 25.3 Real GDP Growth, South Korea, 1995–1999



Source: International Monetary Fund. *International Financial Statistics*. www.imfstatistics.org/imf/.

CASE: FINANCIAL CRISES IN EMERGING MARKET COUNTRIES

Figure 25.4 Unemployment, South Korea, 1995–1999



Source: International Monetary Fund. *International Financial Statistics*. www.imfstatistics.org/imf/.

CH 9

CENTRAL BANKS

FINANCIAL MARKETS &
INSTITUTIONS
MISHKIN AND EAKINS

KRIST DACHARUX
17 NOV 2018
B.E. | FN211

CENTRAL BANKS



A public institution with unique position and power

Links closely to government and financial sectors

Dates back to 1600s (Riksbank, Sweden)

Mandates usually include (1) price stability and (2) full employment

Varies in terms of targets, instruments, and organizational structures

- **Inflation/Monetary growth/Exchange rate**

Trends toward more transparency, accountability, and independence

ROLES OF CENTRAL BANKS

1. **Issues money and supervise payment system**
2. **Conducts monetary policy**
3. **Performs banking services to Government and commercial banks**
4. **Acts as lender of last resort for commercial banks**
5. **Supervises commercial banks**



THE FEDERAL RESERVE SYSTEM



Dual Mandates:

1. Maximum Employment (Unemployment rate)
2. Stable Prices (Inflation)

Note: Phillips curve



Three policy tools:

1. Open market operations (Fed Fund Rate: FFR)
2. Discount rate
3. Reserve requirements

THE FEDERAL RESERVE SYSTEM



Current Chairman:
Jerome Powell
2018-2022

Source: Federal Reserve

STRUCTURE OF THE FEDERAL RESERVE SYSTEM

Designed to diffuse power along the following dimensions:

- Regions of the U.S.
- Government and private sector interests
- Needs of bankers, businesses, and the public

The system includes:

- Twelve Federal Reserve Banks
- Board of Governors (BOG) of the Federal Reserve System
- Federal Open Market Committee (FOMC)
- Federal Advisory Council
- Member Banks (around 2,000)



BOARD OF GOVERNORS

7 governors appointed by the President, and confirmed by the Senate
14-year term

All Board members are members of the FOMC

Sets **reserve requirements and effectively set the **discount rate**.**

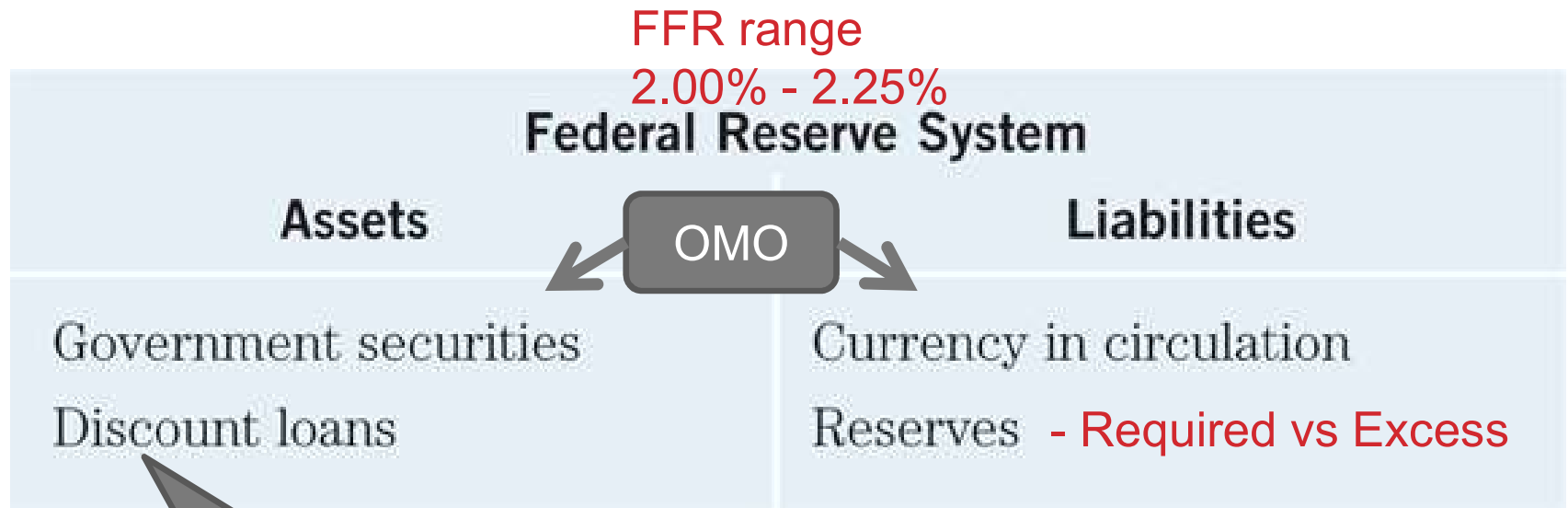


THE FEDERAL RESERVE'S BALANCE SHEET

Federal Reserve System	
Assets	Liabilities
Government securities Discount loans	Currency in circulation Reserves



THE FEDERAL RESERVE'S BALANCE SHEET



Discount rate

Overnight lending
2.50%-2.75%

Reserve Requirement

3% of Net Transaction Accounts (NTA)

FEDERAL OPEN MARKET COMMITTEE (FOMC)

Make decisions regarding open market operations, to influence the **monetary base**.

Open market operations are the most important tool that the Fed has for controlling the **money supply** (along with reserve requirements and the discount rate)

All actions are directed the Federal Reserve Bank of New York, where securities are bought / sold as required.

INSIDE THE FED: FOMC MEETING

Meet eight times each year (about every 6 weeks)

Important agenda items include

- Reports on open market operations (foreign and domestic)
- National economic forecasts are presented
- Discussion of monetary policy and directives, including views of each member
- Formal policy directive made
- Post-meeting announcements, as needed

FOMC MEETINGS IN A YEAR

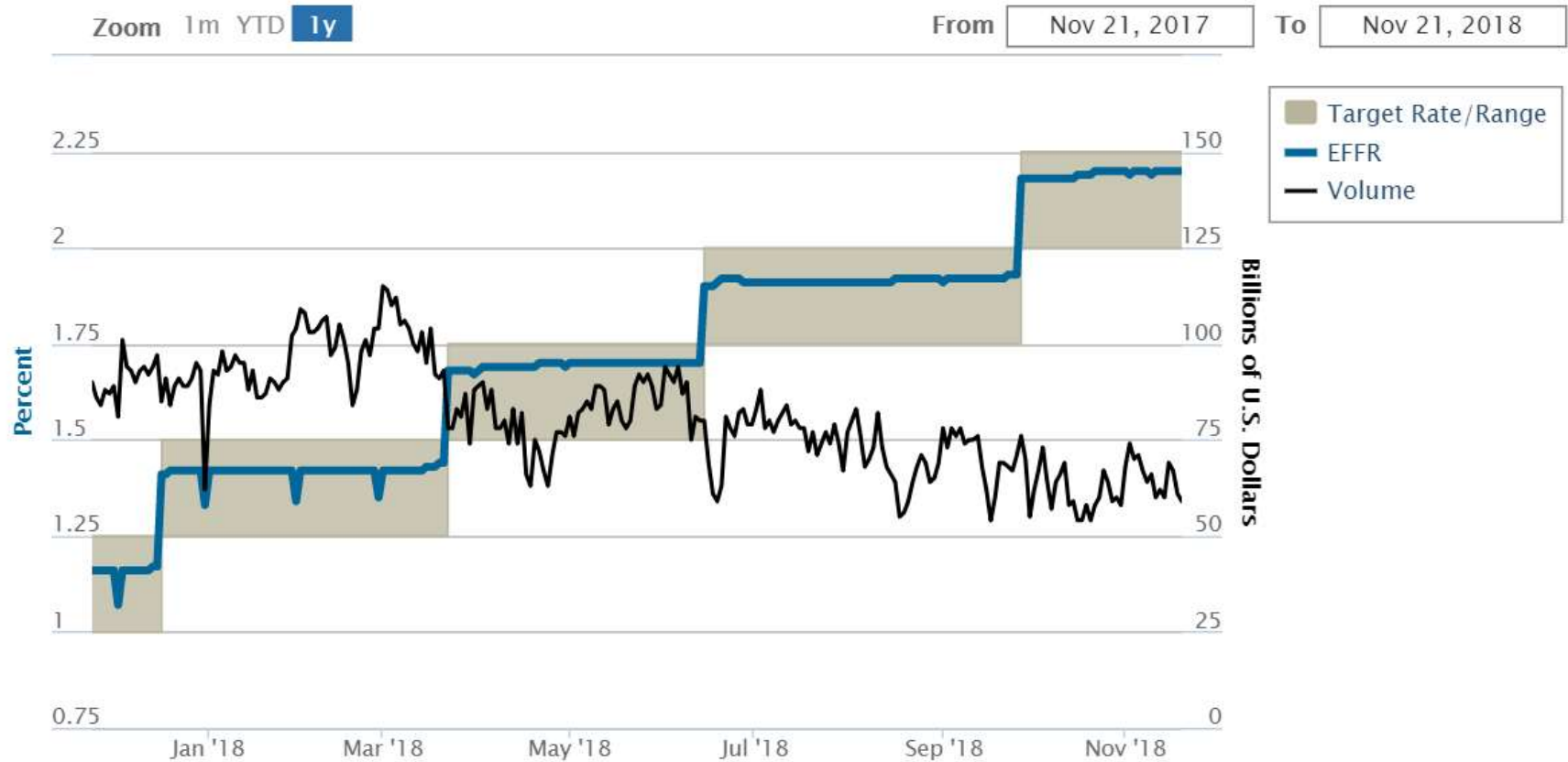
2019 FOMC Meetings	
January	29-30
March	19-20*
April/May	30-1
June	18-19*
July	30-31
September	17-18*
October	29-30
December	10-11*

* Meeting associated with a Summary of Economic Projections.

Source: The Federal Reserve System

FOMC AND FFR

FEDERAL FUNDS CHART



Source: FRBNY

FEDERAL RESERVE BANK FUNCTIONS: GENERAL

Clear checks

Issue new currency and remove damaged currency

Administer and make discount loans to banks in their districts

Evaluate bank mergers and expansions

Liaison between local community and the Federal Reserve System

Perform bank examinations

Collect and examine data on local business conditions

Conduct research related to monetary policy

FEDERAL RESERVE BANK

FUNCTIONS: MONETARY POLICY

“Establish” the discount rate at which member banks may borrow from the Federal Reserve Bank (subject to BOG review)

Determine which bank receive loans

Elect one member to the Federal Advisory Council

5 of the 12 bank presidents vote in the Federal Open Market Committee

THE FRBNY

Oversees some of the largest financial institutions headquartered in Manhattan and the surrounding area

Houses all open market operations

New York Fed chairman as the only permanent member of the FOMC

New York Fed the only member of the Bank for International Settlements (BIS), providing close contact with other foreign central bankers

MEMBER BANKS

National banks (banks chartered by the Office of the Comptroller of the Currency) are required to be members.

State commercial banks may elect to join. Currently, about 1/3 of the commercial banks in the U.S. are members of the system, down from 49% in 1947.

CHAIRMAN OF THE FEDERAL RESERVE SYSTEM

Spokesperson for the entire Federal Reserve System, and supervises the Board's staff

Negotiates, as needed, with Congress and the President of the United States

With these, the chairman has effective control over the system, even though he doesn't have legal authority to exercise control over the system and its member banks.

ECB AND EURO

A monetary union with a single currency (Euro)

19 Members (with Latvia and Lithuania, recently added)

Founded in 1999 by a treaty between the European Central Bank (ECB) and the European System of Central Banks (ESCB).

Housed in Frankfurt, Germany.

Current president: Mario Draghi



STRUCTURE AND INDEPENDENCE OF THE EUROPEAN CENTRAL BANK



Mandate is to maintain **price stability**, with inflation rate below, but close to 2%

The policy group consists of the executive board and governors from the ~~17~~ **19** member countries central banks.



THE EUROPEAN CENTRAL BANK



Difference between the Fed and the ECB:

Only the 17 ~~19~~ members attend the monthly meetings of the ECB, with no staff.

No voting! All decisions are made by consensus.

The ECB holds a press conference following the monthly meeting, while the Fed typically doesn't.

Monetary operations are conducted at the national level, not directly by the ECB.

The ECB is not involved in bank regulation or supervision.



BANK OF JAPAN



Founded in 1882

The Policy Board sets monetary policy, and consists of the governor, two vice governors, and six outside members. All serve five-year terms.

Mandate is "aimed at achieving **price stability, thereby contributing to the sound development of the national economy."**

Inflation target is 2%

No bank supervision role. (Japan Financial Service Agency, JFSA)

BANK OF JAPAN



Recently, Ministry of Finance lost its authority to oversee many operations of the Bank of Japan.

In a recent episode, the new Abe government put pressure on the Bank of Japan to adopt a 2% inflation target against the wishes of its current Governor.

Governor resigned! May suggest that the Bank of Japan's independence is limited.

BANK OF THAILAND



3 key policy committees

- **Monetary Policy Committee (MPC)**
- **Financial Institutions Policy Committee (FIPC)**
- **Payment Systems Committee (PSC)**

Monetary policy

- **Flexible inflation targeting framework**
- **Objective: price stability (sustainable economic growth and financial stability)**
- **Headline inflation target at 2.5% +/- 1.5%**
- **Policy rate 1.5% per annum (1-day repurchase rate)**

BOT MONETARY POLICY

Monetary Policy Committee (MPC)

7 Members (4 external)



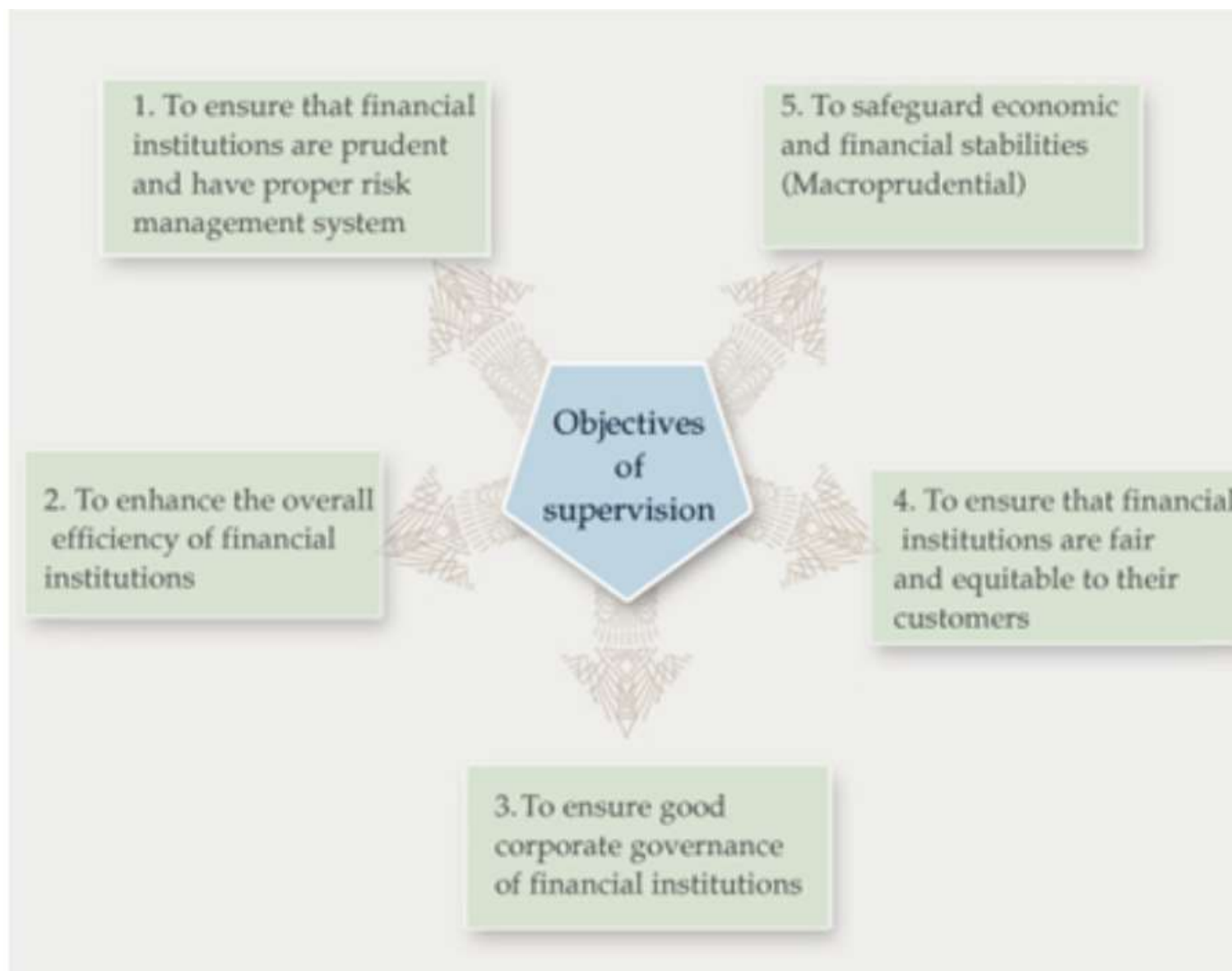
Monetary Policy Committee

- | | |
|------------------------------------|---------------|
| 1. Mr. Veerathai Santiprabhob | Chairman |
| 2. Mr. Mathee Supamongse | Vice Chairman |
| 3. Mr. Paiboon Kittisrikangwan | Member |
| 4. Mr. Jamlong Atikul | Member |
| 5. Mr. Porameteer Vimolsiri | Member |
| 6. (Vacant) | Member |
| 7. Mr. Sethaput Suthiwart-Narueput | Member |

Meets 8 times a year

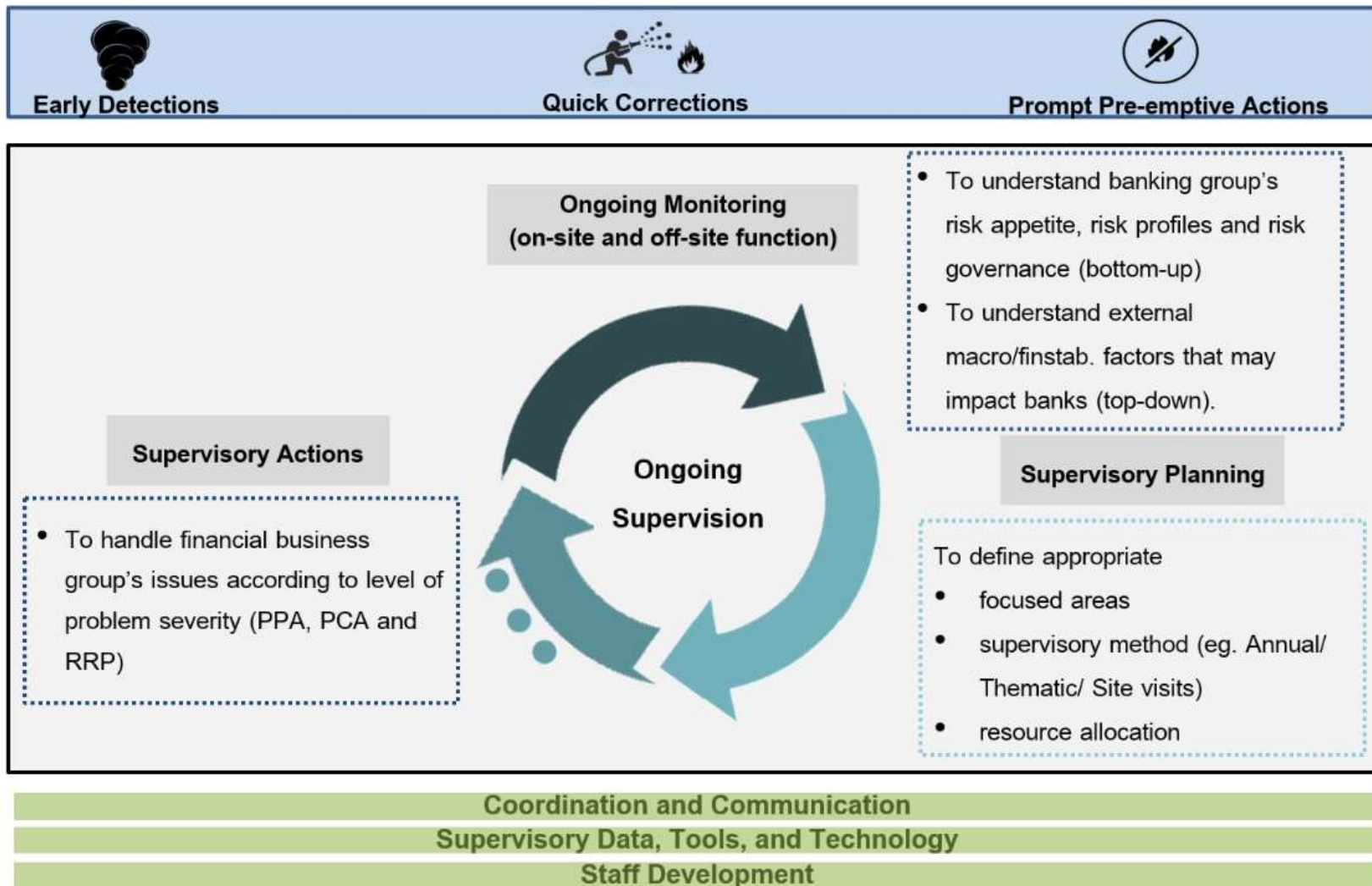
MPC no.	MPC Meeting Date	MPR Press Conference
1/2019	wed. 6 February 2019	
2/2019	wed. 20 March 2019	wed. 3 April 2019
3/2019	wed. 8 May 2019	
4/2019	wed. 19 June 2019	wed. 3 July 2019
5/2019	wed. 7 August 2019	
6/2019	wed. 18 September 2019	wed. 2 October 2019
7/2019	wed. 6 November 2019	
8/2019	wed. 18 December 2019	Thu. 2 January 2020

BOT FINANCIAL INSTITUTION SUPERVISION



BOT FINANCIAL INSTITUTION SUPERVISION

Intended Outcome



BOT FINANCIAL INSTITUTION SUPERVISION

Table 1 Number and Asset Size of
Financial Institutions end of 2015

	Number	% of Total Assets of Financial Institutions
Depository Corporations	2,037	70.4
Commercial Banks *	31	47.8
Specialized Financial Institutions *	6	15.6
Saving Cooperatives and Credit Unions	1,960	6.3
Money Market Mutual Funds	40	0.7
Non-Depository Corporations	6,983	29.6
Mutual Funds	1,374	10.1
Insurance Companies	86	8.1
Leasing Companies	769	2.0
Credit Card and Personal Loan Companies (including Nano Finance) *	42	2.6
Provident Funds	412	2.4
Government Pension Fund	1	1.9
Asset Management Companies *	36	0.8
Securities Companies	52	0.8
Agricultural Cooperatives	3,613	0.6
Pawn Shops	598	0.2

Source: Bank of Thailand

* Businesses under the BOT's Supervision

FINANCIAL CONSUMER PROTECTION CENTER (FCC)

ธนาคารแห่งประเทศไทย | ร้องเรียน | แจ้งเบาะแส | ติดต่อ ศคจ. | EN / TH  

   **ศคจ.**
Ins.1213 ศูนย์คุ้มครองผู้ใช้บริการทางการเงิน
ธนาคารแห่งประเทศไทย

เกี่ยวกับ ศคจ. การบริหารจัดการเงิน สิทธิและหน้าที่ บริการที่ สปท. ทำกับดูแล บริการที่หน่วยงานอื่น ๆ ทำกับดูแล กิจทางการเงิน สื่อและโปรแกรมคำนวณ

หน้าแรก / เกี่ยวกับ ศคจ. / [เปรียบเทียบผลิตภัณฑ์](#)

เปรียบเทียบผลิตภัณฑ์

-  เงินฝาก
-  บัตรเดบิต
-  บัตรเครดิต
-  สินเชื่อส่วนบุคคล
-  สินเชื่อเพื่อที่อยู่อาศัย



TREND TOWARD INDEPENDENCE

In recent years, we have seen a **remarkable trend toward increasing independence**. The Fed used to be substantially more independent than other central banks, but this has changed with the formation of the ECB and changes at other central banks. This trend should continue.

CENTRAL BANK INDEPENDENCE

Instrument Independence: the ability of the central bank to set monetary policy instruments.

Goal Independence: the ability of the central bank to set the goals of monetary policy.

Independence comes with accountability

CASE FOR INDEPENDENCE

Political pressure usually add an inflationary bias to monetary policy.

Political business cycle: Expansionary monetary policy leads to lower unemployment and lower interest rates—a good idea just before elections. Deal with consequences later. (higher inflation and higher interest rates)

Risk of monetization: Government trying to finance its deficits through bonds purchased by central bank, leading to inflationary pressure

Unpopular choice in the best interest of the public: hard choices must be made for the good of the economy

CASE AGAINST INDEPENDENCE

Undemocratic: an elite group controlling an important aspect of the economy, one of the most important tools to direct the economy

Not always successful/correct

EXPLAINING CENTRAL BANK BEHAVIOR

Two competing theories try to explain the observed behavior of central banks:

- Public Interest View*: the central bank serves the public interest.
- Theory of Bureaucratic Behavior*: the central bank will seek to maximize its own welfare.

COMMUNICATION STRATEGY

In the past, very discrete.

The Fed generally likes to keep its actions hidden—not transparent—to avoid conflicts with Congress and other politicians.

Now, toward more transparency

More revealing of FOMC directives (immediately after each FOMC meeting), the FOMC meeting votes, publishes economic projection quarterly (previously twice a year)

