

Current and Future Challenges to Monetary Policy in Emerging Market Economies¹

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SUMMARY

Monetary policy is at a cross road after the financial crisis. When inflation is driven by structural and supply side factors like the cost and availability of goods and services, the link between monetary aggregates or interest and inflation has been weak in the recent years. This has raised a question on the framework of monetary policy that price stability is the core objective for central banks.

There is growing view that monetary policy does not operate in a vacuum, it has a strong interface with the government. Supporting the state policies on growth and employment along with serving the core function are taken as the secondary responsibility of the central banks. Because of complex challenges in a financially integrated world, no single approach to monetary framework will work. For instance, monetary policy should not ignore financial stability, despite focus on price stability. Also the choice of objectives and instruments are conditioned by country context - one framework does not serve all.

Sovereign debt is a setback to monetary policy credibility and prudent debt management is an essential complement to sound macroeconomic policies. Monetary policy must consider the environment under which it is operating. If sustainable debt management is also the function of the central bank, then the trilemma has to be resolved with optimal solution of the conflicting objectives.

Macro-prudential measures are emerging as complements to monetary policy. The coordination or consolidation of the monetary and regulatory authorities is crucial for forging an effective complement between the two measures. Also a logical and rule based approach for the adoption of macro prudential measures has to develop.

Autonomy of the central is a must for an effective operationalization of monetary policy. But it must also be linked to clear performance indicators and accountability. An autonomous central bank without measurable performance indicators and public accountability runs the risk of losing credibility.

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