

Monetary Policy in Asia: Differences Amongst Countries



**GREG HOWARD, ECONOMICS AND MATHEMATICS
ADVISOR: RICHARD FROYEN, ECONOMICS**



Project Background and Goals



- **Background:**

- In an earlier research project, I had discovered that monetary policy in China had a greater affect on exports than the economy in general. I wanted to look into whether this was a general effect or whether it was simply a statistical or Chinese anomaly.
- Monetary policy is very different amongst various Asian countries. In addition to placing different weights on inflation and growth, many of the countries also monitor their exchange rates which can dominate monetary policy choices.
- The financial crisis spread quickly through the world, despite some hopes of decoupling. Two of the ways in which this happened were declining trade worldwide and a global aversion to risk.

- **Goals:**

- I wanted to investigate whether these two channels played a large role in how the crisis spread in Asia.
- I also wanted to look at whether monetary policy responded to the crisis in typical ways when responding to shocks to inflation and output.
- Finally, I want to investigate whether or not the prevalence of the two channels in different countries had any affect on the monetary policy response.

Results



- **The Financial Crisis:**
 - The prevalence of both exports and private bank lending seem to contribute to larger declines in GDP during this crisis.
 - Together, they explain about 36% of the variation in how hard the crisis hit different countries.
 - Prime lending rates did not change that much, but the amount of bank lending dropped significantly. This suggests that the financial aspect of the crisis was primarily amongst subprime loans.
- **The Policy Response:**
 - Not surprisingly, most central banks cut rates during the recent crisis. Pakistan was the only one who raised rates, and they had just had an inflation scare.
 - The policy rates seemed to be very sensitive to inflation levels and to changes in gross domestic product growth rates.
- **The Effect of Exports and Bank Lending on the Policy Response:**
 - When controlling for the change in GDP growth, the amount of bank lending seemed to have no effect.
 - However, exports seemed to make the central banks more aggressive. This could be because the policy has more of an effect, and so the tradeoff with inflation is more worthwhile.