GENERAL DISCUSSION
Policymaker Panel

Chair: Mark Spiegel

Mr. Spiegel: Let's turn to questions.

Mr. Santiprabhob: I have two questions for the speakers. The first question is for all of the speakers. Given that there are quite a number of structural reform initiatives going on in each of your countries, how do you take into account the future impact of structural reforms, given uncertainties about the pace and extent of structural reform measures? And the second question is related to macroprudential measures that have been introduced in your country. How do you incorporate decisions on macroprudential policies into the monetary policy framework?

Mr. Hutchison: My question is directed to Dr. Shirai. Japan's debt-to-GDP ratio is about 240 percent at present. I'm wondering what you think is the normal real interest rate in Japan and how the interest rate level affects the sustainability of the public debt?

Mr. Hoshi: Mr. Hahm, you said macroprudential policies in Korea, such as loan-to-value (LTV) ratio and debt-to-income (DTI) regulations, successfully contained household debt and mortgage lending. But I think they also partially led to increased corporate liabilities, as you showed in one of the figures in your presentation. When I look at the data, what I see is that the banks which relied more on mortgage lending before the introduction of LTV and DTI regulation ended up increasing their lending to already indebted SMEs, small and medium enterprises, with dubious prospects. So I think it's important to recognize the potential side effects of macroprudential policy like LTV or DTI regulation. And I think this relates to what Perry (Warjiyo) pointed out too. LTV regulation in Indonesia reduced mortgage loans, but at the same time it seems that it led to more real estate and construction lending. Although you mentioned that these developments may not be related, I think we should not rule out possible interactions.

Mr. Spiegel: Let me take one more question for this round.

Mr. Ratcliffe: My question is motivated by Joon-Ho Hahm's comments about the decoupling of the real economy and the credit/financial cycles. It's something that we've been discussing at my firm, Blackrock. I want to get your opinion on where you consider us to be in the credit cycle. Are we in the late stage in the credit cycle as indicated by the increase in credit spreads in the past months? Or are we midway through, and is this cycle different following the quantity of easing that we've seen? So is there more to go? And the last part of my question is, do you identify Korea as being closer to where the United States is in the cycle? Or more broadly with emerging markets?

Mr. Spiegel: Thanks. So let's just go in order and start with Dr. Shirai. You may respond to the questions from the floor or your co-panelists, as you choose.

Ms. Shirai: About the first question—whether we take account of structural reforms when we make a policy decision—usually when we make a policy decision it's based on a baseline scenario for the economic outlook. And the baseline scenario takes the present structure of the economy as given. But if, for example, there is a possibility that structural reform might have a positive impact, it is treated as an upward risk to the baseline scenario. About how macroprudential policy is incorporated into our monetary policy decisionmaking, as you know, we are doing very massive amounts of monetary accommodation. We have said we will continue our Quantitative and Qualitative Monetary Easing (QQE) program as long as we find it necessary in order to achieve the 2 percent inflation target. But at the same time, we have said we look at both upside and downside risks related to Japan's economic growth, prices, and financial stability. So if there is some concern related to these considerations, we may make adjustments to our QQE framework. At this moment, we are closely watching financial stability but don't see any serious risks. The debt-to-GDP ratio, 220 percent, is huge. Right now, based on our internal calculations, the equilibrium, natural interest rate is zero percent. With the implementation of QQE, monetary policy in Japan is now very, very accommodative, as the actual real interest rate is less than the equilibrium interest rate.

On the debt monetization issue, we are not supposed to talk about it. But I will say that since QQE was implemented, tax revenue has been growing and the government fiscal balance has been improving. Corporate-sector profits are now the highest in history, and firms are paying a lot of taxes. And so in that sense, monetary policy has helped improve the fiscal situation. In addition, we also introduced a consumption tax hike last year that is also increasing tax revenue. But of course, in the future we will exit QQE and interest rates will rise. So it's quite important for us to make progress on fiscal consolidation now.

Mr. Hahm: Let me first answer the question about how the Bank of Korea actually incorporates macroprudential concerns in making monetary policy. It's a very difficult question. We don't have a unified framework or any strategy that we reveal to the market in regard to how financial stability is incorporated into monetary policy strategy. Rather it depends on the individual policymakers' judgment. But we do monitor quite vigilantly financial stability risk in the financial system. And we do have periodic meetings at the board level to assess the financial stability risk, and we try to share these assessments with the public and also with the government. But the perceived risk really depends on the individual policymakers on the board.

On the question about whether macroprudential policy introduced in the household sector may lead to a kind of substitution effect in other sectors, such as lending to small and medium-sized enterprises, actually, as I showed in one of my graphs, the corporate-sector loan-to-GDP ratio in Korea has not recovered yet up to the pre-crisis level. It's close, but it's still lower, only 105 percent of GDP. So probably it's true that the lower policy interest rate during the last year is causing loans to small and medium-sized companies to pick up slowly. But I'm not sure whether the recovery of small and medium-sized loans is entirely due to our adoption of macroprudential policy measures in the household sector, because it was the Bank of Korea's purpose when it introduced non-interest rate policies like the credit support lending facility to foster more loans to the small and medium-sized sector. Of course, our examiners are closely watching the growing credit in the small and medium-sized sector.

And finally, the question about the decoupling of the financial cycle and real business cycles. The graph that I showed in my presentation is basically for emerging markets. Korea is a little bit different. It's somewhere in between due to the macroprudential policies that I mentioned. Korea's financial cycle hasn't deviated much from our business cycle. But we are now probably at a critical point, as our financial cycle has become more tied to the financial cycle of more advanced economies. For instance, our long-term interest rates have been close to U.S. long-term interest rates even though there are big differentials on the short-term side of the yield curve. This means that the risk and liquidity premia in Korean financial markets have become quite compressed. There is a risk that could change, something we are paying a lot of attention to. But at this point in time, our financial cycle has not decoupled much from the business cycle.

Mr. Warjiyo: On the macroprudential experience in Indonesia, first we have to be clear about whether the immediate objective of macroprudential policy is to achieve financial stability or monetary stability, even though the two goals are linked to each other. If you're concerned with financial stability, then macroprudential policy involves bank stress testing and things like that. If you're concerned about monetary stability, then usually we're talking about the procyclical nature of bank lending and so on. In Indonesia's case there is not much concern about financial systems stability now because our banking system is quite strong. And so there is more on the procyclical nature of bank lending—the boom-bust cycle usually, with excessive lending at the boom stage and contractive lending at the bust. This is why we introduced loan-to-value ratio regulations in the first place. Second, how do we put macroprudential policy into our inflation-targeting framework? In 2013, after we increased the policy interest rate by about 175 basis points, we saw that aggregate lending started to decelerate, but some sectors were not so responsive to the interest rate rise. It's in those sectors, such as housing property and automobile finance, where we employed limits on the loan-to-value ratio. We did not apply macroprudential regulations in other sectors where there were interest rate responses. As I mentioned, the real estate sector is not so responsive to our macroprudential measures because the big developers can resort to overseas borrowing to offset the loan-to-value ratio limits. As I said, from the monetary policy perspective, macroprudential policy works as a complement to our interest rate policy.

Mr. Spiegel: Thank you. Are there any other questions from the audience?

Mr. Williams: I want to go back to Jeff Frankel's paper from yesterday on policy cooperation and coordination. I think all three of you mentioned the Federal Reserve about 572 times. So I was curious about your views on what central bankers could do better on policy coordination beyond having more meetings in Basel. I think it was mentioned yesterday. What are the opportunities in your views, if any, for better monetary policy cooperation and coordination?

Mr. Spiegel: Any other last questions? Let me give you each an opportunity to answer John's question. And then if you add any remarks, we'll close with that.

Ms. Shirai: First, I want to add to my comments on the earlier question about Japanese debt. I want to emphasize that this is a domestic problem, not an external problem, at the moment. Our current account is in surplus, around 3 percent of GDP. And probably we can maintain it near 3 percent in the near future. That means that even though Japan's fiscal debt level is very large, it's covered by the saving investment balance of the private sector. So in flow terms at this moment, we don't have a serious issue. In stock terms, when we look at Japan's net international investment position, it's positive, one of the largest in the world. So we have lots of foreign assets. So that's why Japanese government bonds are still trusted even though the debt-to-GDP ratio is about 220 percent. But that's in gross terms. Because the Japanese government holds asset claims on other parts of the public sector, the debt level is lower in net terms, around 150 percent of GDP. That's why at the moment nobody's really panicked in Japan. So we still have some time, but that doesn't mean the government should not do anything. It has to make progress on fiscal consolidation.

Responding to the question about policy coordination, Japanese currency is one of the key currencies in the global financial system. I think it's very difficult for an individual central bank to coordinate its monetary policy with the policies of other central banks. However, there has been effective coordination through the currency swap arrangements of major central banks, including the U.S. dollar, Japanese yen, euro, Swiss franc, Canadian dollar, and the pound. As I mentioned earlier, during the 2010–12 European debt crisis, the Federal Reserve provided dollar funding and helped mitigate contagion effects and the deepening of banking-sector problems. I think the swap arrangements are becoming more permanent based and have helped global financial stability. Another example of regional cooperation is the Chiang Mai Initiative that now supports multilateral currency swaps among 11 Asian central banks, including the Bank of Japan. This initiative also introduced an Asian bond fund in early 2000 to help develop local-currency-denominated bond markets in Asia after the East Asian crisis. This has helped to make asset markets in the region more liquid and efficient.

Mr. Hahm: I think that's a very challenging question. I think, John, you already have contributed a lot to international coordination of monetary policy by having this kind of conference that enables policymakers to understand each other's problems. Perhaps what policymakers can do is to share more information among central banks and maybe to conduct joint research on, say, the spillover effects of monetary policy to other countries. Such joint research by central banks may help us understand the issues better and how to achieve international coordination among monetary policymakers.

Mr. Warjiyo: In a world of globalized, but independent, monetary policy focused on domestic objectives, I'm not sure if formal international policy coordination can be achieved. I agree with what Jeff said in his session. Cooperation is important in the sense of sharing information and openly discussing issues, such as the spillover effects of monetary policy on other countries. When I look at, for example, U.S. monetary policy communication, compared to 2013, we are now in a better position to understand the direction and likelihood of U.S. monetary policy. In 2013, I don't think we had dot plots about the Federal Open Market

Committee's interest rate path. And now, at least by looking at the dot plots and Bloomberg forecasts and so on, we can take into account the likelihood of a future federal funds rate increase in our policymaking. That's why in Indonesia we put a premium on the possibility of a federal funds rate increase. That's one thing. The other issue, as I said yesterday, the most difficult thing policymakers in emerging markets face is not anticipating when and how much the Fed will raise rates. Rather it is anticipating the market's reaction to the possibility of a federal funds rate increase. It is so much more difficult to predict and to anticipate market behavior and whether the markets will overreact.

Mr. Spiegel: Thank you very much. Please join me in thanking all the panelists for what was quite an interesting session.