

Monetary Policy

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What should be the objective of monetary policy?

Objectives of Monetary Policy

- The monetary policy function of the central bank should have a clear focus.
- Price stability is a desirable objective.
- However, the FSLRC has decided to not specify such a requirement in the Code given that objectives could potentially change over time.

Objectives of Monetary Policy

- The central bank must have precise, quantitative, and monitorable monetary policy objectives.
- These objectives would be decided by the Central Government, in consultation with the central bank Chairperson.
- The specifics of the objectives, to be achieved over the medium-term, would be released in a Statement.
- The Statement would also define what constitutes a substantial failure in achieving the objectives.
- Should such an event arise, the head of the central bank would:
 - ① explain the reasons for failure
 - ② propose a programme of action
 - ③ specify a time horizon over which the target would be achieved

Independence of the monetary policy process

Independence

- ① What kind of independence structure should we adopt for monetary policy formulation?
- ② What should be the composition of the monetary policy committee?
- ③ What should be the composition of the management board of the central bank?

Proposed Decision-making Process

- The FSLRC recommends the establishment of an executive Monetary Policy Committee that would meet on a fixed schedule and vote to determine the course of monetary policy.
- The main briefing report of the central bank's research department to the Committee would be released to the public a day prior to the meeting.
- Decisions of the Committee would be made on a one-person one-vote basis.
- Each of the seven members would submit a rationale statement about his/her vote.
- The voting record and all seven rationale statements would be released into the public domain, with a lag of three weeks.
- The central bank Chairperson would have the power to override the Committee in exceptional circumstances.

Committee Composition

- The Committee will be chaired by the Chairperson of the central bank.
- It will have one executive member of the board of the central bank and five external members.
- External members to include independent experts in the field of monetary economics and finance.
- These members will be appointed by the Central Government.
- In case of two of these members, the appointment will be in consultation with the Chairperson.
- External members will have no management/operational role.
- Their only function in the central bank is to be members of the Committee.
- A representative of the Central Government would participate in the Committee meetings, but would not have a vote.

Accountability, Transparency & Communication

- How to hold an independent monetary policy committee accountable for its decisions?
- How to use transparency and communication as a tool for increased effectiveness of monetary policy?

Accountability Mechanisms

- Accountability mechanisms would ultimately rest with the head of the central bank.
- Under extreme circumstances, the head of the central bank has the power to override the Committee.
- However, he/she would be required to release a rationale statement in public, explaining the reasons for disagreeing with the Committee.

Transparency Measures

- Research report would be released to the public before the meetings of the Committee.
- Regular reports on the monetary policy outlook of the bank to be released to the public.
- Minutes and voting record of every Committee meeting to be made public.

Institutional Structure of the Central Bank

- What is the composition and role of the Board of the Central Bank?
- What is the role of the Advisory Councils for Banking & Payments?

Board of the Central Bank

- The board of the central bank would have up to 12 members; the number of executive members should not exceed 50 percent.
- One of the executive members will be the Chairperson of the Bank (who would be the chair of the board).
- One executive member will function as the administrative law member.
- There would also be nominee members of the Central Government.
- The board would be assisted by two advisory councils, in the fields of banking and payments.

Role of the Board

- Oversee the functioning of:
 - ① *monetary policy*
 - ② *micro-prudential and consumer protection functions for banking*
 - ③ *micro-prudential and consumer protection functions for payments*
- Decision-making about organisational and institutional arrangements would take place at the board.
- In the exercise of micro-prudential and consumer protection functions, all regulations would be issued by the board.
- The board would oversee the functions of the central bank and have overall control of its organisation structure.

Advisory councils for Banking & Payments

- In the regulation-making process, all information associated with a proposed regulation would be placed before the advisory councils.
- The advisory councils would present their views on proposed regulation to the board of the central bank.
- Each advisory council would author a report every year, taking stock of progress in their respective fields.

Mechanisms for liquidity assistance for financial service providers

Mechanisms

- Operate mechanisms through which liquidity assistance is available against adequate collateral.
- The central bank should issue regulations to determine rules of collateral and rules governing liquidity assistance.
- Price structure should be such that the borrowing entity would prefer to first seek regular funding from the market.
- Clear distinction between regular standing facilities and emergency lending, which may be for a relatively longer term.
- Where the borrowing entity is a non-bank, processes should involve mechanisms for co-ordination between the central bank and other regulatory agencies.
- Identity of the borrowing entity would be revealed to the public only after an appropriate lag, while the total amount lent through this facility should be part of the daily reporting requirements.

- Issuance of Legal Tender Currency
- Banker to Banks
- Act as Banker to the Government
- Act as custodian and manager of foreign exchange reserves
- Powers to manage its balance sheet