# MR Chatu Mongol Sonakul: Inflation targeting - a new monetary policy approach for Thailand

Speech by Mr MR Chatu Mongol Sonakul, Governor of the Bank of Thailand, at the Bank of Thailand's International Economic Conference "Practical Experiences on Inflation Targeting" held in Bangkok on 20 October 2000.

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Distinguished panelists,

Ladies and Gentlemen,

This is the second seminar on inflation targeting organized by the Bank of Thailand. But this is the first seminar at international level, with highly distinguished speakers from many famous central banks.

To set the right tone for the seminar, I want to start with a question: what does the general public expect from the central bank?

People invariably want the good life: a high standard of living, abundant goods and services to consume. They also want political freedom, a clean environment, and many other things, but let us concentrate on the economic aspects in order to keep it relevant to central banking.

To give people the good life, the economy has to be generating output at a high level, the highest level in relation to its capacity. The economy will also have to generate enough jobs to accommodate the new workers entering the labor force yearly. For many Asian countries where the demographic slant is heavily towards the younger ages, the number of new workers entering the labor force each year is substantial. Therefore, the level of output has to grow to provide adequate employment.

The people can rightly expect the central bank to have an important role in this: giving them the good life.

But they do not stop here. People also want the good life to continue, avoiding the excessive boom and bust cycles and, of course, avoiding unnecessary crises. They invariably want more and more of better goods and services.

This requires the economy to not only simply produce at a high level, but also to make adequate capital formation to generate a high growth rate. There are many factors other than investment that affect growth - things like productivity, innovation and education. But they are outside the realm of central banking. Within the area of central banking, however, the general public can rightly expect the central bank to provide them with an environment conducive to growth, without the excessive boom and bust cycles and avoiding crisis whenever possible.

What else do the people expect? People also expect a fair distribution of opportunity and income. Central banks generally do not have a direct hand in providing equal distribution of income, much less opportunity. This responsibility generally lies with the overall machinery of government. Nevertheless, high inflation, if it exists, does have an adverse effect on real individuals' income, especially those in the lower brackets who are less able to renegotiate their pay. Therefore, while the central bank does not have direct power to enforce a fair distribution of income, if the central bank fails to do its job properly and this results in high inflation, it can make the situation worse.

Next, the general public also wants the country's exports to be competitive. Here we are talking about the export of goods and services, inbound tourism included. Again, the competitive edge of business depends on many factors outside the scope of central banking: marketing know-how, research and development, and technology included. And when one looks at competitive advantage of firms at the international level, things like quotas, trade protection and trade negotiations do add complications to the equation.

But there is one factor that cuts across all considerations and that is inflation. If the inflation rate in a country far exceeds those in its trading partners, it will erode that country's competitiveness over time. Therefore, the central bank can affect the country's export competitiveness, and the public can rightly expect the bank to guard against this.

Finally, the people invariably want transparency. They want to know how the central bank views the situation, how it acts and how it can be held accountable for its action. They will also want to see whether the central bank is capable of looking ahead into the future.

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How can the central bank in an emerging economy like Thailand best deliver to the people all that they expect? My answer is inflation targeting.

The best environment that the central bank can provide for the economy to attain a high level of output and steady growth is one with price stability. Under inflation targeting, the Monetary Policy Board has to look ahead 18-24 months and adjust its stance today to influence the outcome of the future. This will help minimize the boom and bust phenomenon. The floating exchange rate regime will also help prevent imbalances from building up excessively, hence minimizing the risk of major crises.

In terms of transparency and accountability, inflation targeting is probably the best tool of communication. While the general public may have difficulty understanding and keeping track of monetary growth targets, it fully understands inflation, the index of which is calculated and announced by an independent agency, in the case of Thailand the Ministry of Commerce. The regular publication of inflation reports will also help inform and educate the public much better than in the past.

In the case of Thailand, inflation targeting is the best tool to ensure high output, sustainable growth, export competitiveness, prevention of a worsening of income distribution and a transparent and accountable central bank. The Bank of Thailand last year announced our explicit intention to control inflation, and the range of 0 to 3.5% of core inflation was announced in 23 May 2000. Since the beginning of the year, we have seen the yield on 10-year bonds drop from 7.91% per annum to 6.1%. While other factors may have helped toward this reduction of long term borrowing costs, I am sure that public confidence in our commitment to control inflation was certainly one of the important factors.

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The first seminar we organized concentrated on the principles of inflation targeting and laid the overall groundwork. In this seminar, we will go deeper into its implementation, its relevance to emerging economies, and the problems that it may face in the environment of large public debt overhang. We are very fortunate indeed to have with us eminent speakers, most of them from countries that have successfully applied this technique. I therefore strongly urge the audience to take advantage of the presence of the experts by asking questions and airing your concerns to the fullest extent possible. I very much hope that by the end of the seminar, you will all become convinced.