THE BANK FOR INTERNATIONAL SETTLEMENTS AND BANK INDONESIA
JOINT WORKSHOP ON STRUCTURAL DYNAMIC MACROECONOMIC MODELS IN ASIA PACIFIC ECONOMIES

OPENING REMARKS BY
MR. BUDI MULYA, DEPUTY GOVERNOR OF BANK INDONESIA

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Distinguished speakers,

- Professor Volker Wieland, J. W Goethe University of Frankfurt
- Professor Watanabe, Hitotsubashi University
- Professor Iwan Jaya Azis, Cornell University
- Mr. Douglas Laxton, IMF
- Mr. Eli Remolona, Head of Economics for Asia and Pacific of BIS
- Mr. Made Sukada, Head of Directorate of Economic Research and Monetary Policy of BI

Distinguished Workshop participants, Ladies and Gentlemen,

First of all, I would like to welcome you all to this most beautiful island of Bali and to the Workshop on Macroeconomic Modeling in Asia Pacific Economies, jointly organized by Bank for International Settlements and Bank Indonesia. It is indeed the most gratifying experience to me in welcoming such a fairly balanced combination of speakers from both academia and practitioners of central banks and international organizations, as well as and the workshop participants representing a number of central banks in the region. I would also like express my sincere appreciation to Mr. Eli M. Remolona of the BIS for his tremendous efforts to bring up prominent speakers to this two-day workshop. The BIS continued support to invest in human capital of central banks in the region is truly appreciated.

Ladies and gentlemen,

We are now witnessing tremendous challenges faced by central banks and monetary authorities as well as policy makers around the globe, in dealing with heightened uncertainties in global financial market originated recent sub-prime mortgage turmoil in the USA. At the same time, the persistently high energy and food prices in global markets have been giving an extra pressure to most countries around the globe such that inflation has become every where phenomenon.

We are also aware that in this era of globalization, it is difficult, if not impossible, for a country to isolate its domestic economy from external shocks. Economics textbooks tell us that globalization through financial integration offer plenty benefits to the countries involved, especially in term of a greater access to a greater market. However, at the same time it could complicate the task of policy makers in pursuing and maintaining macroeconomic stability, for many countries with less developed financial markets.

Those factors have put the credibility of monetary policy on test for every central banks and monetary authorities around the world. In this respect, macroeconomic modeling plays significant role especially for central banks which set inflation as they overriding objective and nominal anchor for monetary policy as such preemptive or forward looking policy becomes the heart of the policy idealism. The biggest challenge for modelers in every central bank is how to cope with both and tailor between recent development in economic theory and practical aspects in attempts to develop more reliable and credible macroeconomic model.

Against this background, I certaintly hope that we could make the best use of this workshop for sharing experiences in dealing with current challenges. A broader objective of this workshop is that one could learn from other countries' experiences in building structural macroeconomic models that are needed for, medium and long-term forecasting..

In order to ensure the high quality and benefit of the workshop, I understand a number of prominent academics and central bankers specializing in macroeconomic modeling have been invited, including Professor Volker Wieland from J.W. Goethe University of Frankfurt, Professor Watanabe from Hitotsubashi University, Dr. Sungbae An from Singapore Management University, Dr. Shaun Vahey, from Melbourne Business School, Prof. Iwan Jaya from Cornell University, and Dr. Douglas Laxton from IMF. Indeed, I truly appreciate your contributions to this workshop.

Ladies and Gentlemen,

Discussing important aspects and relevant issues on structural macroeconomic modeling to support inflation targeting framework is certainly very important as many central banks have a focused mandate that is to maintain price stability. To carry out this mandate, a central bank must have a way to quantify the link between current changes in monetary policy instrument and future values of the targeted variable.

One of the cutting-edge classes of structural macroeconomic model has been the Dynamic Stochastic General Equilibrium (DSGE). Recently, a number of central banks have become increasingly interested in using DSGE for monetary policy analysis and formulation. Despite these rapid advances and the resulting growing interest, many central banks only partly use DSGE models to support their monetary policy decision making process.

There are reasons why DSGE models have not been part of the core monetary decision-making frameworks. *Firstly*, DSGE models are constructed based on a strong theory so that to prove their ability that they can fit the data is very challenging. *Secondly*, models may suffer from misspecification and wrong parameter identification. *Thirdly*, its high complexity poses strong challenges to modellers in communicating the results to policy-makers. *Lastly*, lack of expertise as DSGE requires staffs that are proficient in economic modelling, statistics and programming.

Ladies and gentlemen,

Bank Indonesia is one the 22 countries in the world that adopt inflation targeting framework. Inasmuch, we put a great concern upon our macroeconomic models development. As a small open economy, Indonesia's economy is exposed by the challenges of global economic integration and recent fast growing economic uncertainties. In this context, our modelling activities always put focus on adapting our macroeconomic models with those developments. I am also fully aware that development of models should not be considered as a terminal point since the theoretical aspect and technology within the models continue developing. In this regard, we also strive to keep up with development of DSGE in other central banks as well as in the academic world which will be discussed further in this workshop. In this regard, I'm very confidence that this workshop will be very valuable for Bank Indonesia and I hope this is also true for all distinguished participants.

Finally, let me once again, express my deepest appreciation to the Bank for International Settlements for its strong supports in making this workshop possible. On a personal note, please accept my apologies as I could not join you for the dinner tonight as I have to go back to Jakarta this afternoon for an unscheduled hearing with the parliament.

Herewith, I formally commence the workshop. I wish you all a fruitful workshop and enjoyable stay in the paradise island of Bali. Thank you.

Budi Mulya

Deputy Governor *of* Bank Indonesia