

## Tarisa Watanagase: Inflation targeting – a reflection on Thailand's experience

Opening remarks by Dr Tarisa Watanagase, Governor of the Bank of Thailand, at the Bank of Thailand's International Symposium on "Challenges to Inflation Targeting in Emerging Market Countries," Bangkok, 13 November 2006.

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Honorable Guests,  
Distinguished Participants,  
Ladies and Gentlemen,

First, I would like to extend a very warm welcome to all of you here today. This is the second time that the Bank of Thailand organizes a symposium at an international level. Our first international symposium, "Practical Experiences on Inflation Targeting," was held in October 2000, a few months after we had adopted inflation targeting as a new monetary policy framework for Thailand. But this symposium today is the first one that brings together central bank governors, senior central bank executives, world-renowned academics and policy experts from leading international organizations. Many of you have extremely tight schedules and some have to travel a very long distance. I would like to express our great appreciation for your presence and very much hope that what we will learn together in this symposium is beneficial to all of us.

Ladies and Gentlemen,

Thailand formally adopted inflation targeting as a monetary policy framework on May 23, 2000. The change in policy regime was a result of our search for an appropriate nominal anchor after the floating of the Thai baht in July 1997. In the interim period, we used monetary aggregates as our policy target. It was during that time that we came to recognize that the relationship among monetary aggregates, inflation, and output in Thailand did not have sufficient stability and predictability to make monetary aggregates a good nominal anchor of our monetary policy. Inflation targeting then appeared as a natural choice for our new monetary policy regime. From that day onward, price stability has become the Bank of Thailand's overriding policy objective. The core inflation rate was, as it is now, to be kept within a 0-3.5 percent range.

When Thailand adopted an inflation target some six years ago, the policy regime was a relatively uncharted territory for emerging market economies. Although the history of inflation targeting dates back to 1990 with the adoption of an inflation target by the Reserve Bank of New Zealand, prior to 1998, inflation targeting was pursued mostly by developed economies. The first substantial cross-country study of inflation targeting, published by Ben Bernanke, Thomas Laubach, Frederick Mishkin and Adam Posen, who is here today, in 1999, was mainly about inflation targeting experiences of developed economies, with the exception of Israel. The situation looked vastly different from today where emerging market inflation targeters outnumber developed market ones.

Ladies and gentlemen,

Six years may be too short to claim definite success for inflation targeting in Thailand. Nevertheless, inflation targeting as a monetary policy framework has served us well over the period. When we first adopted an inflation target, our economy was still very much affected by the 1997 crisis. While there are several factors that contributed to the subsequent economic recovery, many believe that our monetary policy conduct was certainly among the crucial ones.

During this six-year span, we have had episodes of both deflationary and inflationary scares. It was not a long time ago that the talk on global deflation made headline everywhere. For a brief period, we pondered what policy actions we should take if the core inflation rate were to breach our lower target. Then the surge in oil prices during the past couple years steered our worry in the opposite direction. The fact that we have been able to keep inflation in check all these years alongside the sustained economic expansion has convinced us of the decision that we made six years ago.

One attraction of inflation targeting as a policy framework is its inherent forward-looking aspect. Forecasts of future inflation play a crucial role in our policy decisions. Looking ahead 18-24 months into the future greatly reduces the risk that our policy rate will fall behind the curve.

The framework of inflation targeting is also flexible enough to accommodate secondary policy objectives. This is often referred to as "constrained discretion." As long as inflation forecasts are within

the target range, monetary policy can be used to avoid undesirable volatility on output. In addition, the framework's focus on long-term price stability, as opposed to short-term one, gives an extra room for maneuver. These flexibilities allow us to adapt rapidly and without undue stress to new developments and shocks.

Among its other virtues, inflation targeting is purported to improve the transparency and accountability of monetary policy and to help enhance the central bank's credibility. These were also what we hoped the new framework would deliver for us.

On the transparency front, the establishment of the Monetary Policy Committee as the decision-making body has transformed the way we conduct monetary policy. Today, the public can see what decisions have been taken, by whom, against what objectives, and for what reasons.

On the accountability front, we have now learned to operate in the environment where the public expects us to keep inflation within the target range. This makes us extremely conscious of every policy decision we make, which in turn allows us to avoid potentially costly policy mistakes.

But perhaps the biggest change is on the credibility front. The way we conduct policy and our track record have helped us to regain any credibility we may have lost following the unsuccessful defense of the baht. Public confidence in the Bank enables us to anchor private-sector expectations about future inflation, which in turn reinforces the effect of our policy.

Yet despite all the good things inflation targeting has brought us, it is not a panacea. In other words, there are limits to inflation targeting. An apparent example here is development of asset prices. Also, past successes do not guarantee future success. The economic environment we live in today is inherently dynamic and continuously evolving. We therefore need to be aware of both old and new challenges to inflation targeting as a monetary policy framework.

Some observers have cautioned that Thailand's inflation targeting regime has not been truly tested. In particular, there has not been an incident that gives rise to a severe tension between inflation stabilization and other objectives. For example, Thailand has not experienced sharp exchange rate movements that come into conflict with the inflation objective. Nor has the country been in a situation where persistent supply shocks lead to a significant slowdown of the economy amidst rising prices.

Operationally, there are also issues on how far we should push transparency. A few inflation targeting central banks now put forecasts of policy rates in their inflation reports. Should Thailand follow these practices? Should we publish our MPC minutes as the FOMC does? And should we announce the weight we put on output gap stabilization relative to inflation stabilization explicitly in the inflation report. In the past, we only mentioned these weights occasionally in passing. All these questions will sooner or later have to be tackled when our inflation-targeting regime gains maturity.

Ladies and gentlemen,

The issues I have mentioned, as well as other challenges confronting the conduct of inflation targeting in emerging economies, are the main focus of this international symposium. We are honored to have with us five leading international researchers who will present their in-depth studies on some of these issues along with highly regarded discussants and panelists, not to mention the rest of the participants. The goal is to have an intellectual exchange of ideas and practical experiences on these important issues. To make the most out of the one-and-a-half-day event, I strongly urge the audience to ask questions and air your thoughts and/or concerns to the fullest extent possible. Your active participation will help us central banks improve our conduct of monetary policy. After all, as BOE governor Mervyn King puts it, "inflation targeting is a framework designed for a world of learning."

Thank you for your attention.