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The adaptation of monetary policy to the constraints of the global financial crisis by central banks of ASEAN-5 countries

Sorina BOTIŞ[1]

Abstract: *Global financial crisis represented an important test for central banks, generating multiple challenges that gave rise to both expanding their monetary policy tools and redefining its role in the financial system. The present work aims to identify the characteristics of the monetary policy by the central banks of the five countries belonging to ASEAN-5 Group(Indonesia, Malaysia, the Philippines, Singapore and Thailand), during and after the outbreak of the international financial crisis. For this purpose we carried out a comparative analysis between the five central banks belonging to the Group, both in terms of the challenges of the monetary policy and the type of measures taken in response to the first. The analysis shows that central banks have different levels of responsibilities, corresponding to the internal economic and financial realities, and also different ways of adaptation and adjustment of their monetary policy.*

Key-words: *ASEAN-5, central bank, monetary policy, inflation targeting, key interest rate*

1. Introduction

Triggered initially in the United States, the last economic and financial crisis has expanded rapidly in Western Europe and, amid globalization, spread fastly worldwide, changing the shape of the world economy. The objective of this paper is to examine how the Asian financial crisis affected the major ASEAN -5 countries: Indonesia, Malaysia, the Philippines, Singapore and Thailand, how they were affected indirectly by their connection with the global market, considering that the liberalization of financial flow has led to increasing foreign investment banks on the internal market.

External dependency has been a weakening of national financial system by generating a bigger burden for central banks of these countries.

Thus the financial crisis hit the economy through the trade channel, as a result of economic openness. To emphasize the importance of foreign trade, figures 1 and 2 show the evolution of the value of exports and imports in goods and services of

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[1] Transilvania University of Braşov, sorina.botis@unitbv.ro

ASEAN-5 countries, between 2007 and 2009, and the data in the table below (Table 1. *Top 5 export and import ASEAN-5 partners by country)*, show for 2007, the opening towards partners countries belonging mainly to the US and the Asian area.

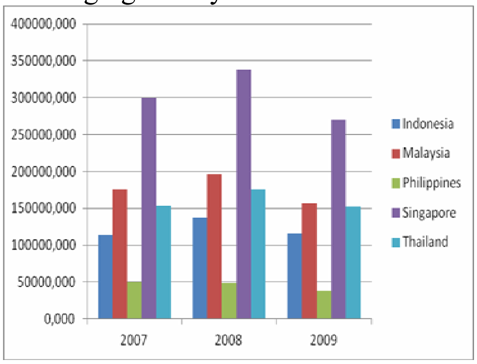

Fig. 1. *ASEAN-5 exports by countries (in US$ Mil)*
(source: *Author – representation of the data from World Economic Outlook databases, available at www.worldbank.org)*

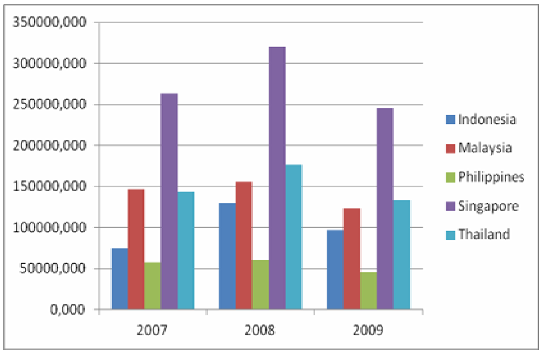

Fig. 2. *ASEAN-5 imports by countries(in US$ Mil)*
(source: *Author – representation of the data from World Economic Outlook databases, available at www.worldbank.org)*

Partner countries	Indonesia	Malaysia	Philippines	Singapore	Thailand
US	10,21%	15,65%	10,4%	8,95%	12,61%
Japan	20,71%	9,21%	14,47%	-	11,81%
China	8,48%	8,78%	11,39%	9,66%	9,68%
Singapore	-	14,54%	-	-	6,24%
Hong Kong,	-	-	11,50%	10,46%	5,87%

Table 1.*Top 5 export and import ASEAN-5 partners by country (partners share %)*
(source: *IMF, World Economic Outlook, available at www.imf.org)*

Another channel for the spread of the crisis is the financial one, as a result of limited access to external funding, alongside that of confidence in these economies which have prompted investors to pull back from this region, the exchange rate channel, for the countries concerned about the direct inflation targeting (Table 2.*The ASEAN-5 central banks which apply the inflation targeting strategy)*, through the depreciation of their currencies and higher volatility of exchange rate.

Country	Starting year	Inflation target	Targeting arrangement
Indonesia	2005	7.40%±1%	Inflation target for 2008;2009 and 2010 is 5%±1%; 2011-2015 is 4.5%±1%
Philippines	2002	4.5%±1%	Inflation target changes according to the annual calendar
Thailand	2000	0.0% – 3.5%	The Bank of Thailand has been conducting monetary policy under a flexible inflation targeting framework

Table 2.*The ASEAN-5 central banks which apply the inflation targeting strategy*
(source: *Central Banks' Annual Reports)*

2. Objectives

The present paper aims to highlight the role of central banks and monetary policy in managing the effects of the global financial crisis (Papadia 2013, 8), with an emphasis on the five countries (Indonesia, Malaysia, the Philippines, Singapore and Thailand), that make up the Association of Southeast Asian Nations (ASEAN-5).

At the same time, shows how central banks assuming responsibilities that have exceeded their institutional framework, led to the adoption of a monetary policy with a wider applicability, assuming measures able to determine the recovery of the financial system.

To contribute to the financial stability, the central banks have applied not only the traditional monetary policy instruments like open market operations, standing facilities, but also the unconventional policy measures for providing additional incentive both to financial system and economic activity, from forward guidance, quantitative easing to credit easing (Borio and Disyatat 2009, 5), even each one has different effects (Williams, 2014), depending on the structure of the financial system or other factors. Another objective is to show how are these kinds of measures implemented by the central banks and with what effects (Shirakawa 2013, 72)

The subject developed in this paper expands the issue through the analysis of the central banks' reactions to the international financial crisis, central banks that although do not have global significance, become relevant at the regional level.

3. Research methods

The complex activity of central banks presume as one of the main tasks to define and implement the monetary policy, and involves in addition a number of other functions such as prudential supervision of credit institutions, maintaining financial stability, but this article focuses exclusively on monetary policy function.

The way of application of monetary policy after the start of the global financial crisis, is based on the identification of both the challenges faced by central banks of SE Asia region and of the measures taken by these.

Thus I'll use a comparative analysis regarding monetary policy defined and applied by the central banks of Indonesia, Malaysia, the Philippines, Singapore and Thailand, who have a number of common characteristics including: are members of the same economic community; have the same route for financial and monetary integration(development of capital market, capital account liberalization, financial services liberalization, cooperation in terms of currency), have the same model of economic development, belong the same regional block.

Analysis is made on two separate periods: for years 2007-2008 and 2012-2014, appropriately triggering the global financial crisis and its overrun.

Data and information are collected mainly from Annual Reports of the central banks of ASEAN-5 countries, from the statistics of the World Bank and the International Monetary Fund.

4. Results

4.1. Challenges of the central banks during the global financial crisis

The recent global financial and crisis put the central banks in the face of new responsibilities, in relation to the recovery capacity of economies, the stability of financial systems and the fiscal and macroeconomic policy instruments, the exposure to higher financial and credibility risks.

Facing the challenges, that experience reviews the central banks' ability to provide, simultaneously, the price stability, as the primary objective of monetary policy, and the financial stability.

According to the information collected from the Bank of Indonesia(BI), Bank Negara Malaysia (BNM), Bangko Sentral ng Pilipinas(BSP), Monetary Authority of Singapore (MAS), and Bank of Thailand (BoT), the challenges faced by these banks can be reduced to: prevent/reduce the disturbances on the interbank markets; managing inflationary phenomenon; managing the risks of excessive liquidity; improvement of the liquidities transfer; reducing the rate of currency risk; preserve the stability of the banking system; supporting/stimulating lending activity; maintaining financial stability.

Challenges came amid a saving supersaturation, consequence of increasing economic and financial process in the global economy of the countries to which they refer. The existence of abundant liquidity generated very low levels of interest rate, accompanied by their low volatility.

The main causes that accelerated the process of liquidity expansion, may be summarized as follows:

- the global imbalance builds up the US trade deficit and ASEAN 5 countries surplus(the volume of US imports has increase both the volume of ASEAN 5 exports, that means deficit for US and surpluses for ASEAN-5)
- the high level of savings and international reserves generated capital flows from East to West
- the relatively high potential growth, with excessive capital flows in the ASEAN-5 countries
- the new financial innovations: the process of collateral debt obligations (CDOs), and credit default swaps(CDS)

The need for excessive liquidity risk management, has resulted in a series of type of requirements for central banks, such as maturity mismatch control (BNM), capital control(BSP), liquid asset control and Maturity mismatch control (MAS) (Fiscal Policy Research Institute Thailand, 2010; Bank Negara Malaysia, 2008).

Managing inflationary phenomenon has been different for the five central banks, there are differences in approach between countries that have adopted inflation targeting strategy (Indonesia, Malaysia, the Philippines), and non-inflation targeters like Singapore and Malaysia.

The common denominator for how evolved inflation in these countries, has been both the rising of global oil (all these countries are oil importers), and food prices (food price have more than doubled from January 2007 to May 2008) and relatively weights of these items in the CPI(Consumer Price Index) basket(Fig. 3) These have translated into a higher inflation in all these countries, becoming the main driver of its growth.

The main causes that led to higher food prices were the share of food and energy in total consumption, increasing demand and decreasing supply of food, rapid urbanization and industrialization that led to quality deterioration of agricultural resources, rising energy prices led to rising costs of fertilizer, irrigation and transport, even with 30-50%, maintaining the rising food prices. The Phillippines caries the greatest burden being the world’s largest rice importator and having the highest food weights in CPI basket(46,6%, before Indonesia with 43,3%, Thailand 36,1%, Malaysia 33,8% and Singapore with 23,0%), having one of the highest inflation rate during its Group(3,2% in 2009, lower than in Indonesia 4,8% ,but far from Malaysia and Thailand inflation rates, 0,6% and – 0,8%)(IMF Statistics). Indonesian money supply and price level grew faster than in other countries during the Group and that explain the high level of the inflation in 2009 and in the following years (5,1% in 2010 and 5,7% in 2011). The average annual growth rate in money and quasi money was 12,95% in 2009; 15,4% in 2010, 16,43% in 2011. The strong contraction of the economy led the central bank to cut the key interest rate during 2008 and 2009 due to pressures on the financial system and inflationary pressure (7,75% in Mar. 2009 from 8,25% in the last decade of 2008, to 6,5% at the end of the year).

Price stability depends on the ability to control the money supply, which result from exchange rate policy. During the crisis the currency of Thailand (Thai Baht), experienced the greatest depreciation, followed by Malaysia (Malaysian Ringgit). The Indonesian Rupiah falling from Rp 9,160 to the US Dollar in July 2008 to a low of Rp 11, 238 to the US dollar in December 2008, with depreciation recorded at 22,7%. The Philippines peso reversed the depreciation trend and regained its value of 2000, and the Singapore Dollar to US Dollar fell from S$ 1,4148 to the US$ in 2008 to S$ 1,4545 to the US$.

In this context, the central banks also implemented some operational policies on the foreign exchange and national currencies markets. The objective was to provide short-term liquidity in money market while simultaneously optimizing bank liquidity management. These measures were mainly maintaining an adequate foreign exchange reserves and launching foreign currency repurchase agreements (repo).

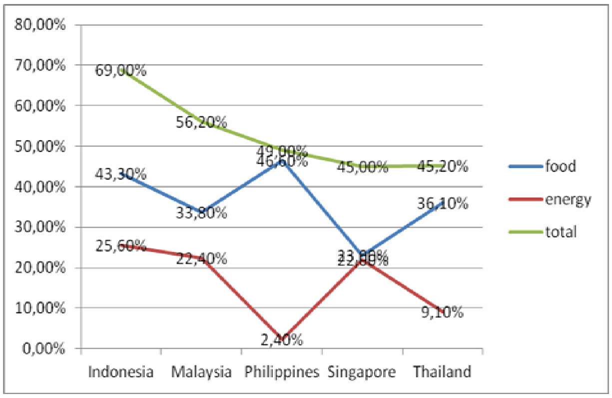

Fig. 3. *Food and energy weight in CPI Basket*
(source*: Author – representation of the data from National Statistics Offices and Central Banks, available at:* www.bis.org*)*

Facing the challenges, central banks took a number of policies to safeguard macroeconomic and financial stability. In order to ensure a stable long-term output growth with price stability, central banks have acted avoiding excessive swings of monetary aggregates and keeping their growth rates in line with output growth.

5. Conclusion

The second half of 2008 and the beginning of 2009 have proven that the correlations between economic, fiscal, monetary policies and the real economy are much stronger than predicted. The globalization has accelerated and facilitated the spreading of the financial crisis from the United States to all over the world.

Despite the global crisis, ASEAN 5 countries have registered an economical growth. Singapore and Malaysia, the two wealthiest and most open economies during the Group, were quickly rebuilt just one year after the crisis. Singapore has recorded the most spectacular growth of 14,7% in 2010, compared to 1,3% in 2009 and – 5,7% in 2008. Malaysia's economic growth was 7,42% in 2010, compared to-1,51% in 2009 and -3,3% in 2008. The Philippines has registered a 7,0% economic growth rate in 2010, compared to 1,1% in 2009 and 1,7% in 2008. Indonesia, the largest economy in the region, has registered an economical growth of 6,1% in 2010, 6,4% in 2011, 6,2% in 2012.

So in subsequent years the crisis, these economies have enjoyed strong economic growth and low inflation. One of the main responsibilities of central banks in the period following the crisis, was the objective of keeping inflation near target.

However, as we can see in the figures below, only Thailand managed to maintain consistently the inflation rate under the target, while inflationary pressure in Indonesia has increased and the Philippines exceeded the inflation target in the early part of Q4 in 2014.

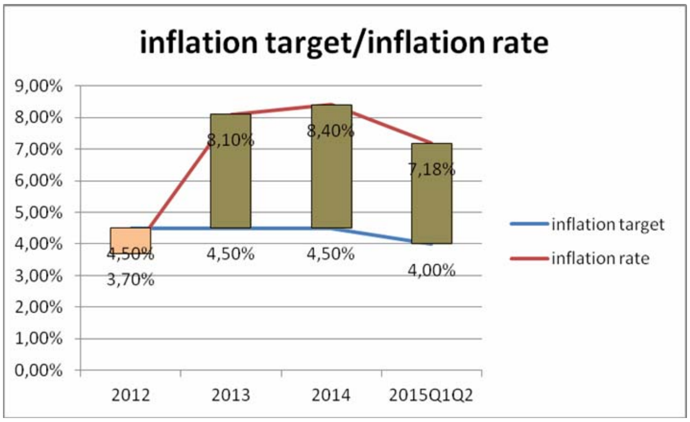

Fig. 4. *Indonesia's inflation rate evolution compared to inflation target*
(source*: Author – representation of the data from The World Bank Group: Data Bank 2012, available at:* www.dataworld.org)

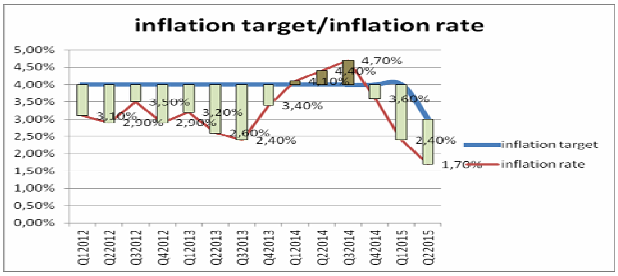

Fig. 5. *The Philippine inflation rate evolution compared to inflation target*
(source*: Author – representation of the data from National Statistics Offices and Central Banks, available at: www.bis.org)*

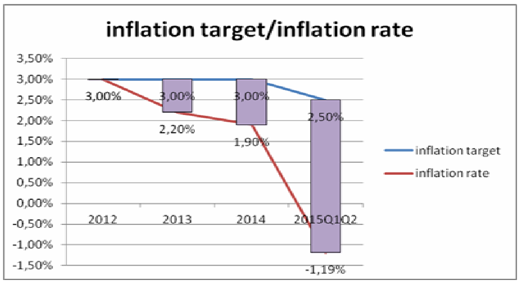

Fig. 6. *The Thai inflation rate evolution compared to inflation target*
(source: *Author – representation of the data from IMF Regional Economic Outlook, available at: www.imf.org)*

Far from exhausting the subject of the central bank's role and importance in managing the recently global financial crisis difficulties, we conclude that globally must be promoted economic and monetary policy measures that support maintaining the global economy positive evolution, in terms of avoiding risks of a slowdown in economic activity or a significant inflation deterioration.

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