Incorporating Financial Stability into Monetary Policy Framework: The Bank of Thailand's Experience

Warapong Wongwachara, Bovonvich Jindarak,
Sophon Tunyavetchakit and Chutipha Klungjaturavet

Bank of Thailand

Abstract

Since the aftermath of the Global Financial Crisis during 2007-2008, financial stability (FS) has become top priority for central banks around the world. The conduct of monetary policy (MP) sees no exception. By leveraging on the existing literature, we propose a systematic approach to incorporate FS considerations into MP framework. This starts with calculating financial cycle (FC) which is a measure of financial imbalances and a predictor of financial crises. The interaction between FC and business cycle variables such as output gap provides important information for policymaking, for it could stipulate an inter-temporal trade-off between financial and price stability. We then look at an FS dashboard which consolidates pockets of risks facing the financial sector, and show how it may be used in conjunction with FC in FS surveillance. Finally, we consider the calibration of monetary and macroprudential policies in order to design the optimal policy mix. As a demonstration of our approach, we discuss, in each section, an on-going attempt at the Bank of Thailand to systematically incorporate FS into flexible inflation targeting.

JEL Classification: E52, G01, C54

Keywords: Financial Stability, Monetary Policy Framework, Policy Trade-off