Session 4: Monetary policy challenges in a low interest rate environment

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Similar to advanced and emerging economies, real interest rates have experienced a downward trend in the DR...

Source: CBDR
This is explained by lower inflation expectations and stronger macroeconomic fundamentals since 2012, with the adoption of Inflation Targeting...

![Inflation Expectations Graph](image)

**Current Account Balance (% GDP)**

2010: -7.5
2011: -7.5
2012: -6.4
2013: -4.1
2014: -3.2
2015: -1.8
2016: -1.1
2017: -0.2
2018: -1.4

**Non-financial Public Sector Balance (% GDP)**

2012: -6.5%
2013: -4.2%
2014: -3.6%
2015: -0.4%
2016: -2.8%
2017: -2.9%
2018: -2.4%

Source: CBDR
This structural change and lower international interest rates contributed to a reduction in the neutral real interest rate (r*) ...
In this context of lower interest rates, an additional challenge that MP has faced is the incidence of supply shocks in the economy...
In particular, during 2014-2016 the DR experienced a positive supply shock associated with the reduction of oil prices...

Source: CBDR
Recent studies evidence that the positive supply shock implied a higher growth rate and lower inflation in DR during this period...

**GDP growth, historical decomposition**

- Supply shock
- Demand shock

**Inflation, historical decomposition**

Source: CBDR
1. If **MP reacts** to inflation deviations with an expansive PM...

It could cause the economy to overheat and generate financial bubbles, in a context of positive GDP gap.

2. If **MP does not** react to inflation deviations...

It could generate a "de-anchoring" of economic agents’ expectations and loss of credibility in the central bank.
After realizing it was not a transitory shock, the CBDR applied expansive MP measures, in order to keep inflation expectations anchored...

...This was **consistent with Latin American** countries, which reacted according to their net commodity exporter/importer position.
As a result, inflation expectations remained anchored to the center of the target, decoupling from the short-term inflation dynamics....
In addition, the CBDR combined the traditional MP tools with macroprudential measures and a more intensive communication strategy...

Macroprudential policies

- Creation of the Financial Stability and Macroprudential policies committee.
- Publication of the Financial Stability Report.
- Reserve requirement, as a countercyclical tool.
- Implementation of limits to the net position in foreign currency.

Additional measures under evaluation:
- Liquidity Coverage Ratio, Net Stable Funding Ratio and limits to leverage.
- Adapt capital requirements for market risk to Basel.
These improvements in the communication strategy have led to greater CB transparency...

**Communication strategy**

- Use of forward guidance in monthly monetary policy communiqués.
- Semiannual publication of the Monetary Policy Report.
- Dissemination of the results of macroeconomic expectations surveys.
- Regular presentations of macroeconomic outlook by the governor of the CBDR.

**Central Bank Transparency**

(Index, maximum score is 15)

Source: IMF