FOREWORD

Over the past two decades, many advanced and emerging economies experienced low and relatively stable inflation rates. At the same time, inflation appears increasingly to be decoupled from economic activity. The literature largely studies the changing nature of inflation dynamics and, in particular, the shifting relationship between inflation and economic activity. This research project on “Price-setting Behavior and Inflation Dynamics in SEACEN Member Economies and Their Implications for Inflation” adds to the discussion about the changing nature of inflation dynamics in several SEACEN economies and puts forward the results of a project team under the auspices of the SEACEN Centre.

The project team consisted of representatives from the Autoriti Monetari Brunei Darussalam; Reserve Bank of India; Bank Indonesia; Bank of Mongolia; Central Bank of Myanmar; Bank of Papua New Guinea; Bangko Sentral ng Pilipinas; Central Bank of Sri Lanka; Central Bank, Chinese Taipei; Bank of Thailand and, State Bank of Vietnam. SEACEN wishes to express its sincere gratitude to the participating central banks for their support for this project.

The project was led by David Finck, PhD student in Economics, and Peter Tillmann, Professor of Monetary Economics from the Justus Liebig University Giessen, Germany. Both were appointed Visiting Research Economists at the SEACEN Centre in 2018. Sincere gratitude goes to Dr. Ole Rummel, Director of Macroeconomic and Monetary Policy Management (MMPM) at the SEACEN Centre, for his overall support, suggestions and lead role at all the stages of the project. The assistance of SEACEN staff members of MMPM, in particular Mrs. Jami’ah Jaffar, Dr. Victor Pontines and Dr. Rogelio Mercado is most gratefully acknowledged.

SEACEN is pleased to have been able to provide input for the project at a research workshop and seminar held at the SEACEN Centre where the findings of the project were presented and discussed. We would also like to acknowledge the helpful comments and suggestions from Scott Davis, Senior Research Economist and Advisor, Federal Reserve Bank of Dallas on the integrative report prepared by the project leaders. The views expressed in this study are those of the authors and do not necessarily reflect those of the SEACEN Centre or the SEACEN member central banks/monetary authorities.

Hans Genberg
Executive Director
The SEACEN Centre

March 2019
EXECUTIVE SUMMARY

Over the past few years, Asian economies exhibited high growth and relatively low inflation rates. It is often argued that the process of inflation determination changed towards a more benign trade-off between economic slack and inflationary pressure. Factors such as global integration into goods and capital markets, the adoption of formal inflation targeting and changes in structural determinants of inflation such as oil and food prices, to name just a few candidates, potentially change the nature of inflation dynamics in small open economies.

This collaborative research project on “Price-setting Behavior and Inflation Dynamics in SEACEN Member Economies and their Implications for Inflation” studies the changing nature of the inflation process in SEACEN economies from different perspectives and draws policy conclusions.

We obtain three key findings:

1. Global as opposed to local determinants of inflation are increasingly important. Global shocks such as oil price shocks and global demand shocks explain a large share of the variation in inflation. Global determinants also change the slope of the Phillips curve.

2. The persistence of the inflation process changes over time, which in turn affects the time needed for inflation to return to the mean following a shock. Reforms in the institutional design of monetary policy such as the adoption of inflation targeting change the nature of inflation persistence.

3. The pass-through of energy prices and oil price, for example, to headline inflation is time-varying and country-specific.

Overall, our results suggest that monetary policy in small open economies, which are well integrated into global markets for goods, services and capital, should take these structural changes into account. A policy framework based on an inflation target and a flexible exchange rate is well suited to cope with the changing inflation process.
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