



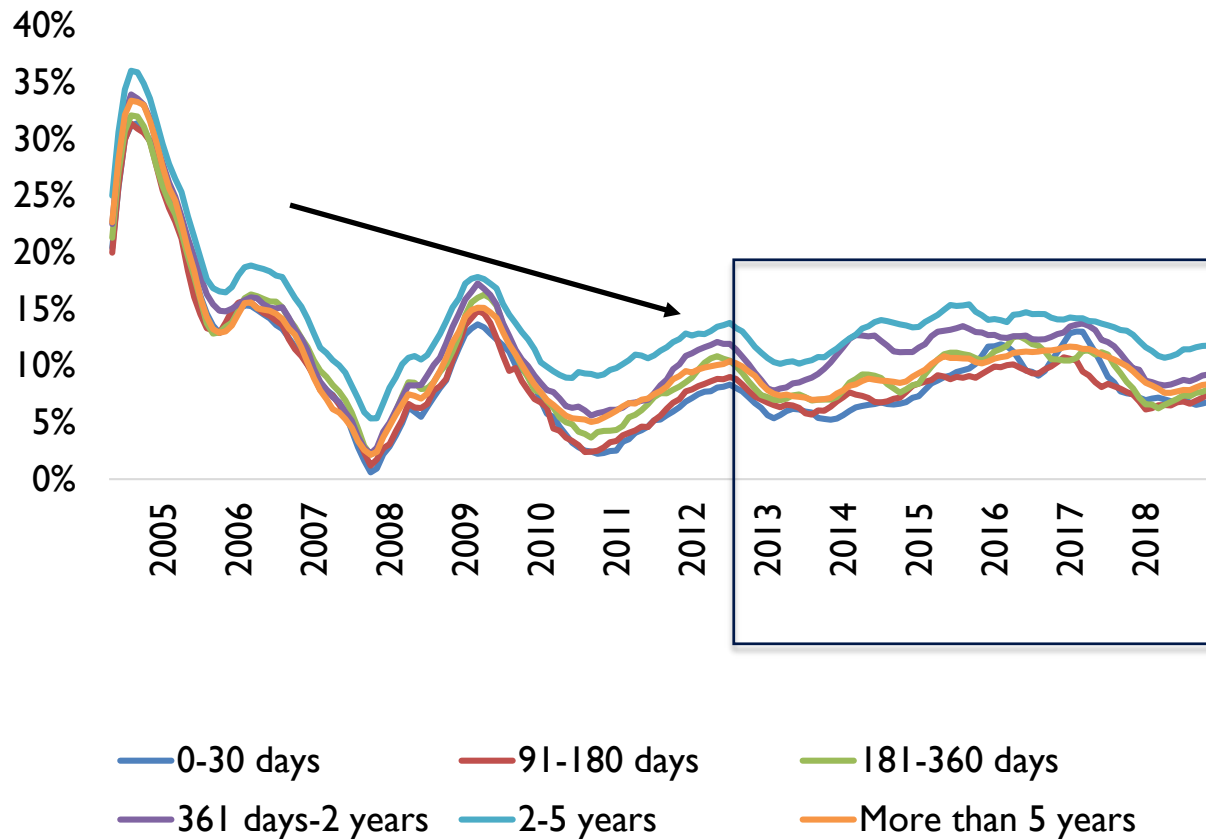
# **Session 4: Monetary policy challenges in a low interest rate environment**

**Joel González P.**

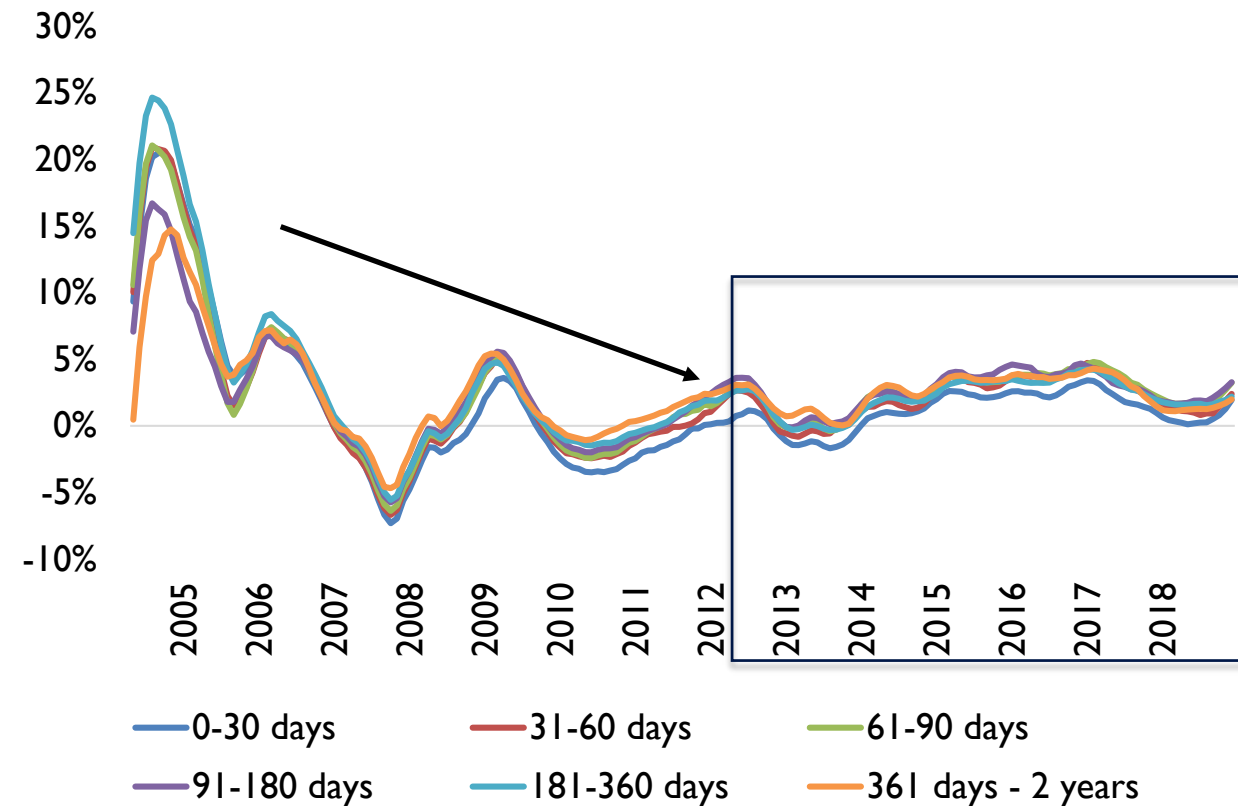
**September 2019**

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

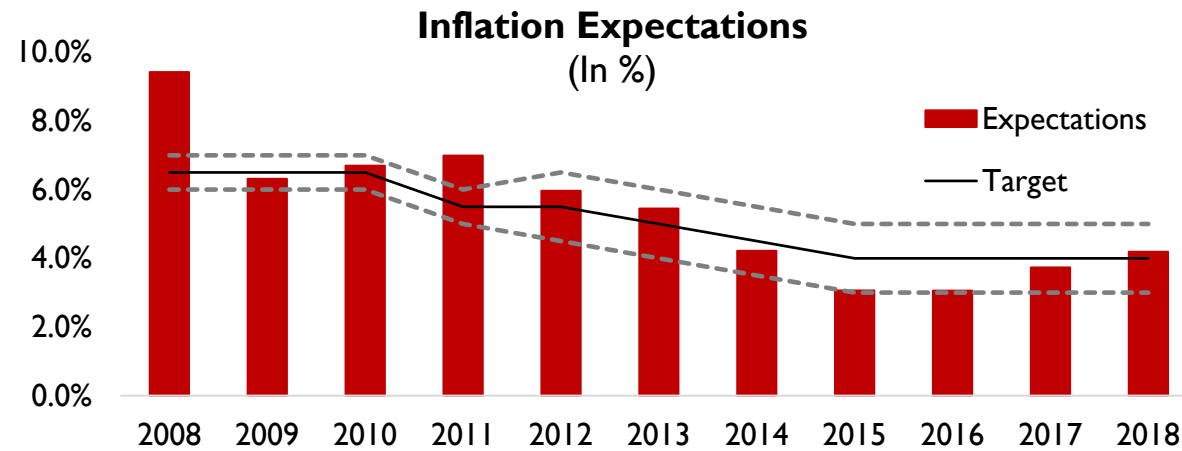
**Loans real interest rate**  
6 month MA



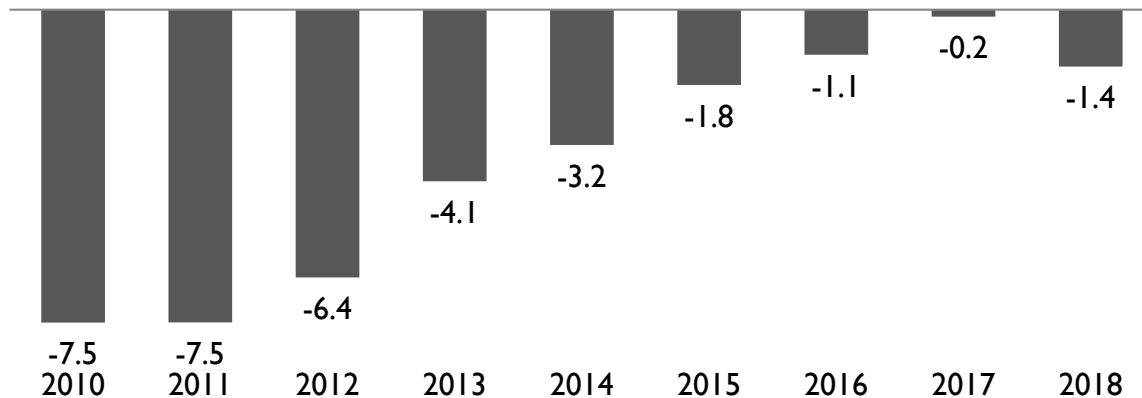
**Deposit real interest rate**  
6 month MA



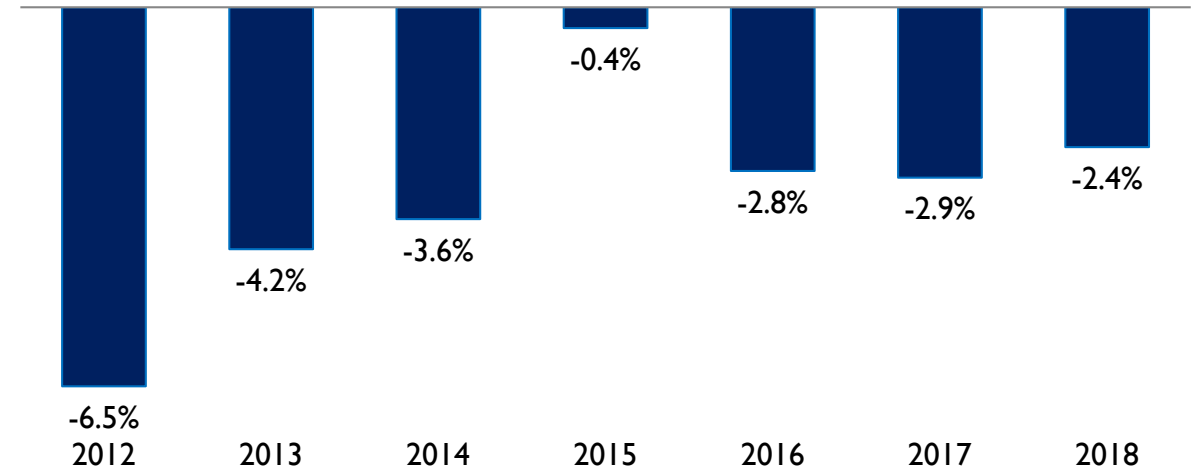
# This is explained by lower inflation expectations and stronger macroeconomic fundamentals since 2012, with the adoption of Inflation Targeting...



**Current Account balance (% GDP)**

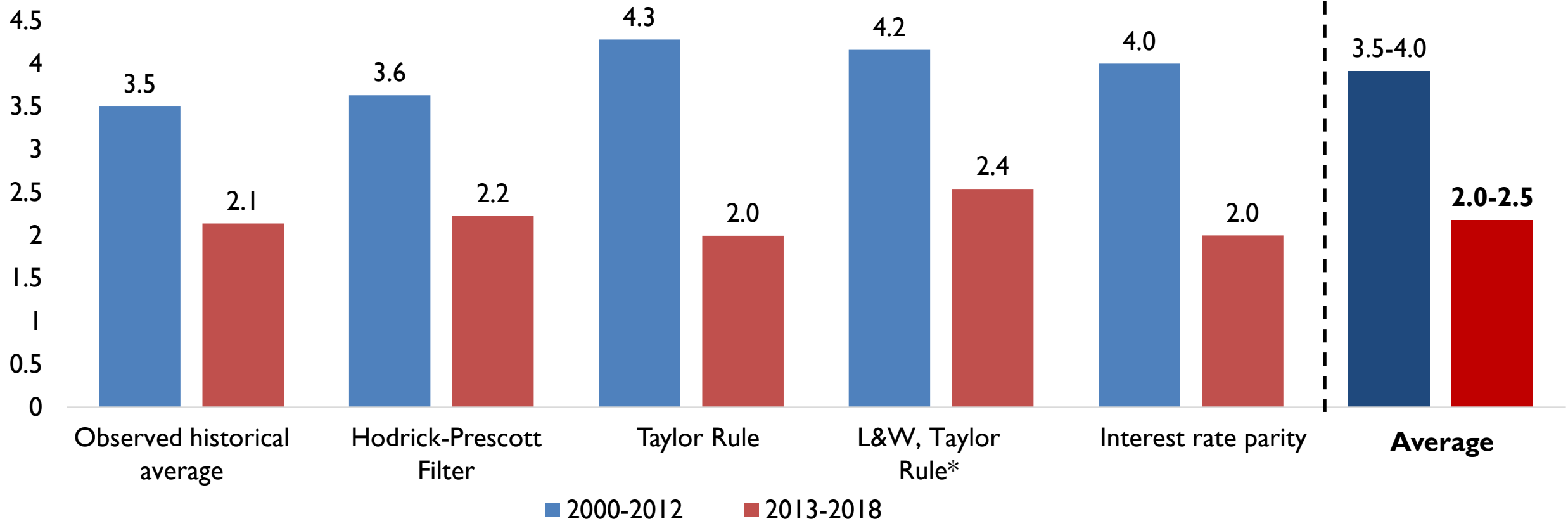


**Non-financial Public Sector Balance (% GDP)**




# This structural change and lower international interest rates contributed to a reduction in the neutral real interest rate ( $r^*$ ) ...

**Short term  $r^*$  estimates for DR  
(In %)**



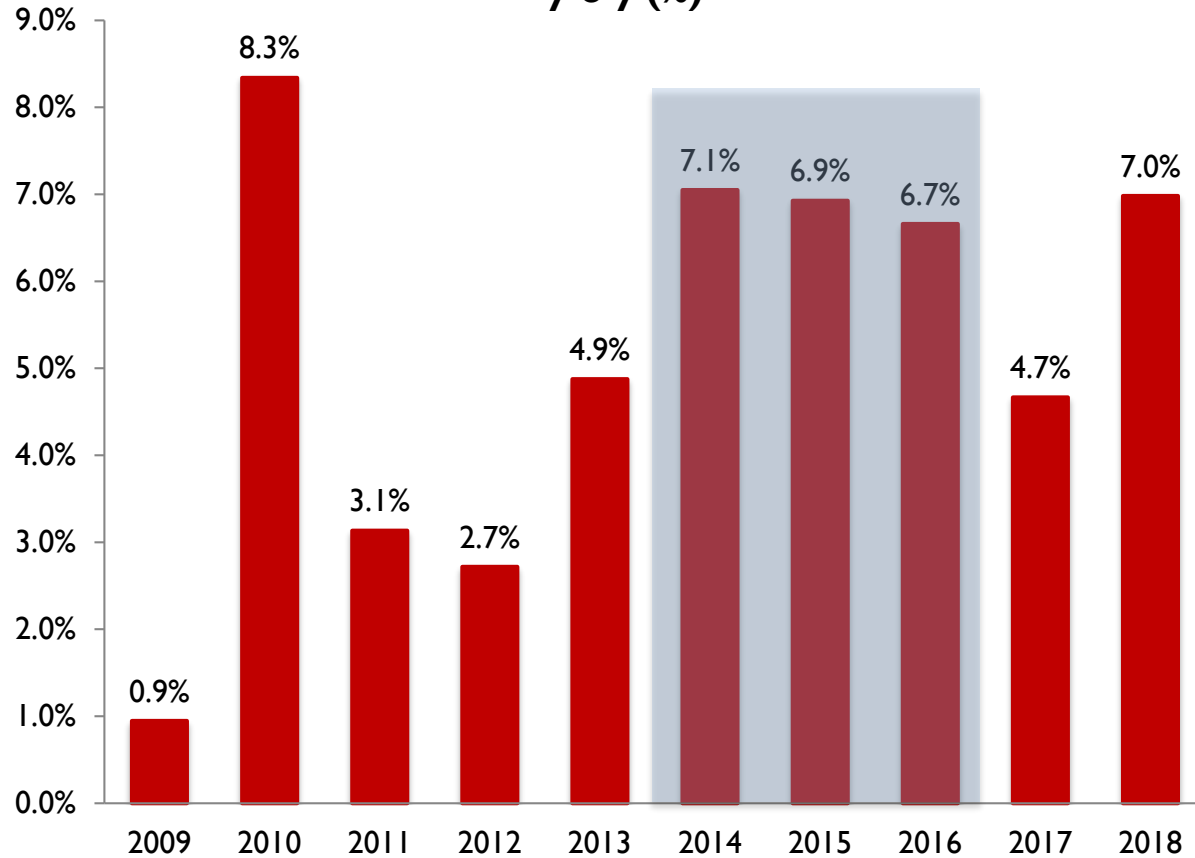
\*Estimates for 2000-2012 with original L&W methodology. For 2013-2018, Taylor's rule is included



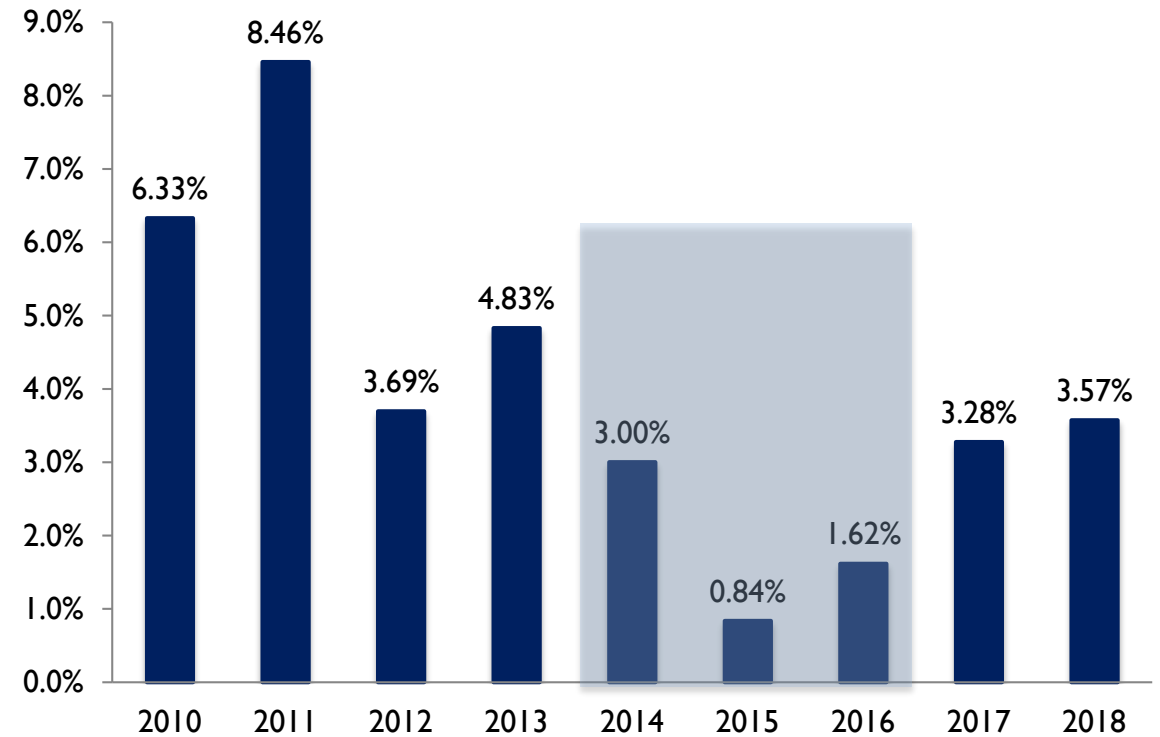
**In this context of lower interest rates, an additional challenge that MP has faced is the incidence of supply shocks in the economy...**

# In particular, during 2014-2016 the DR experienced a positive supply shock associated with the reduction of oil prices...

**Real GDP growth  
y-o-y (%)**

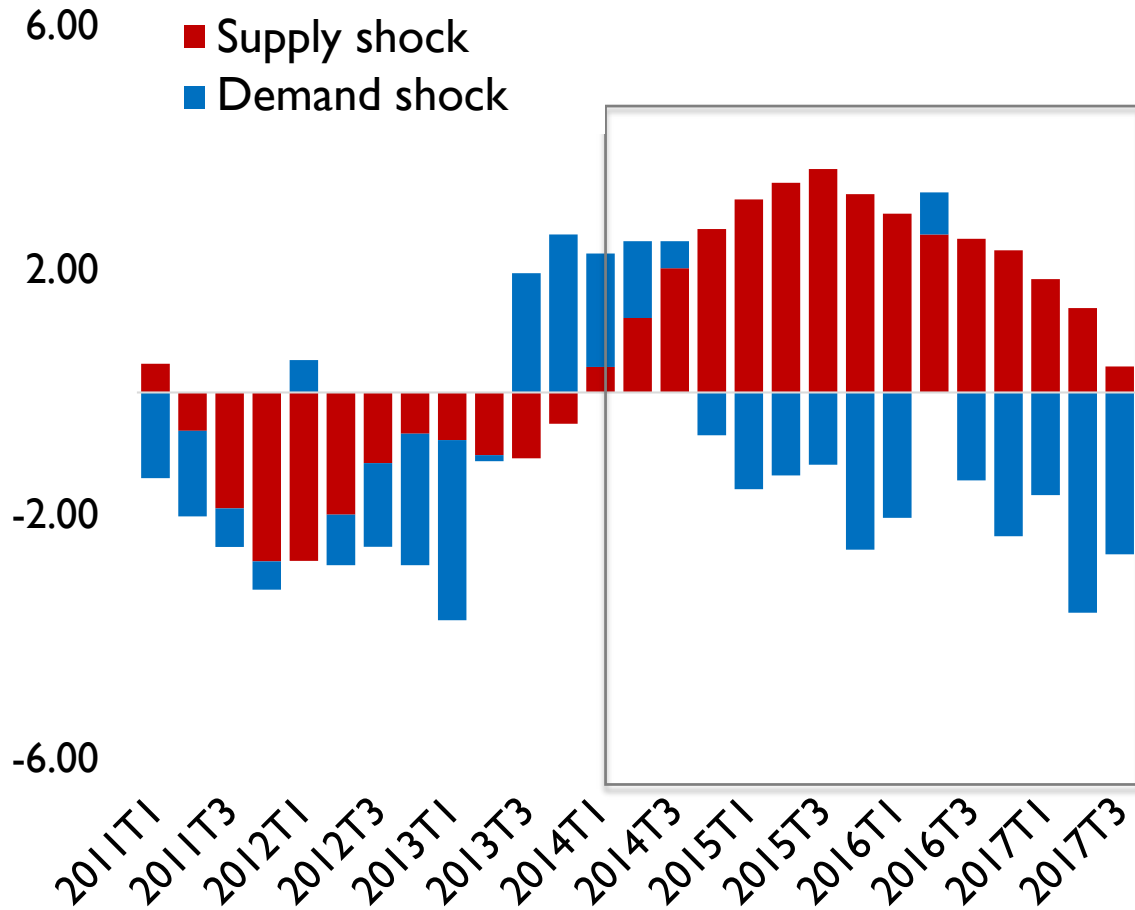


**Inflation  
Average (%)**

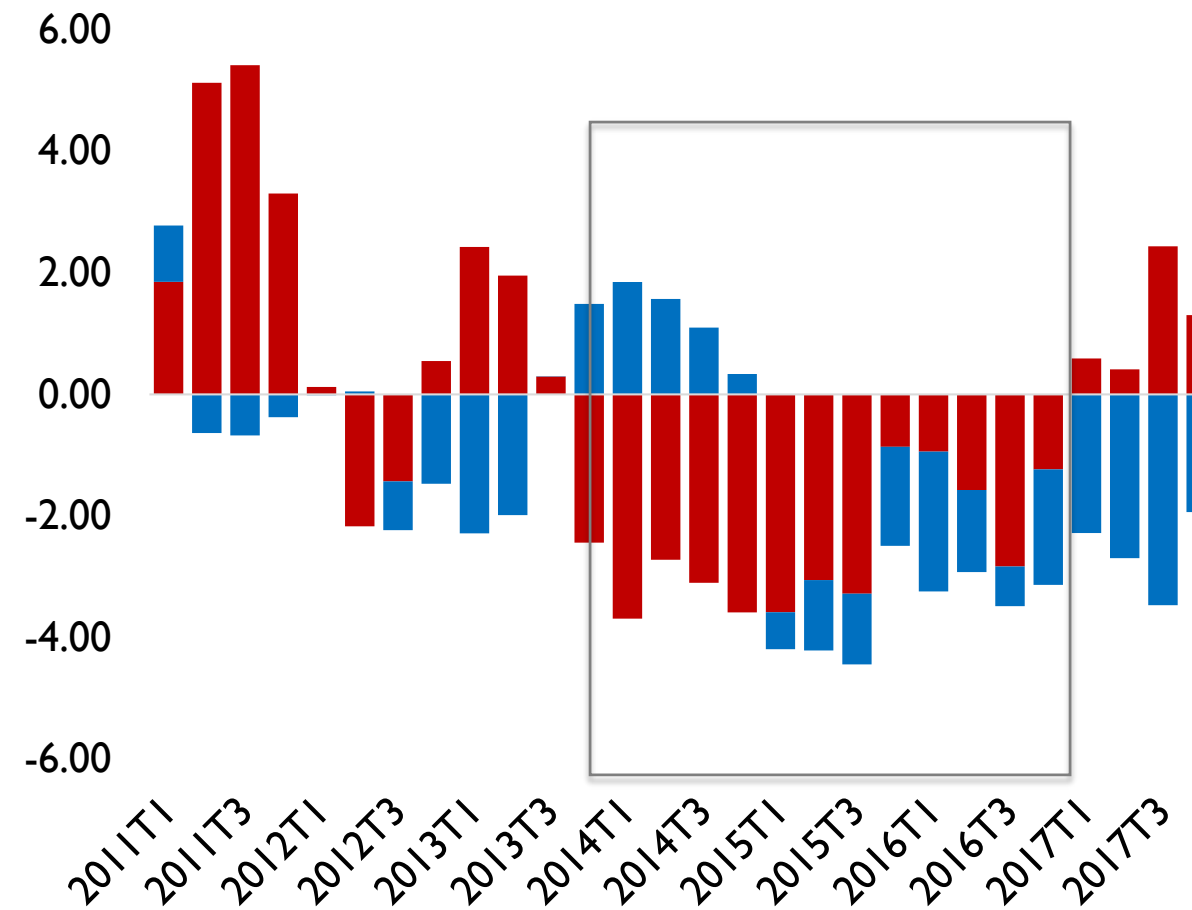


# Recent studies evidence that the positive supply shock implied a higher growth rate and lower inflation in DR during this period...

**GDP growth, historical decomposition**

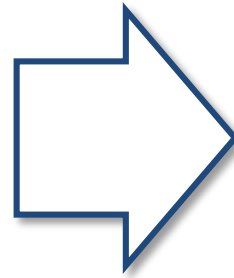


**Inflation, historical decomposition**



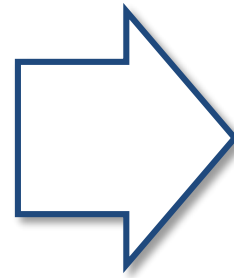
# In such an episode of supply shock, monetary policy faces a trade-off...

**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...

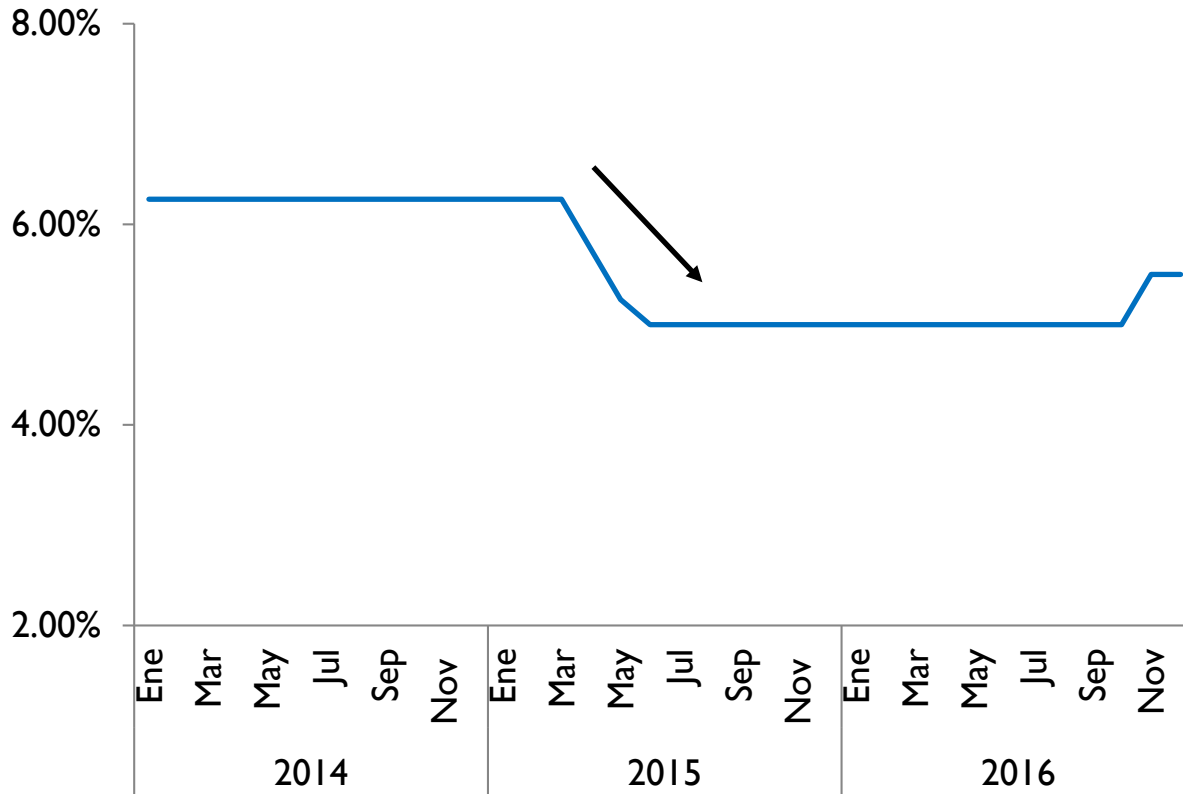


It could generate a "de-anchoring" of economic agents' expectations and loss of credibility in the central bank.



# After realizing it was not a transitory shock, the CBDR applied expansive MP measures, in order to keep inflation expectations anchored...

**Monetary Policy Rate**

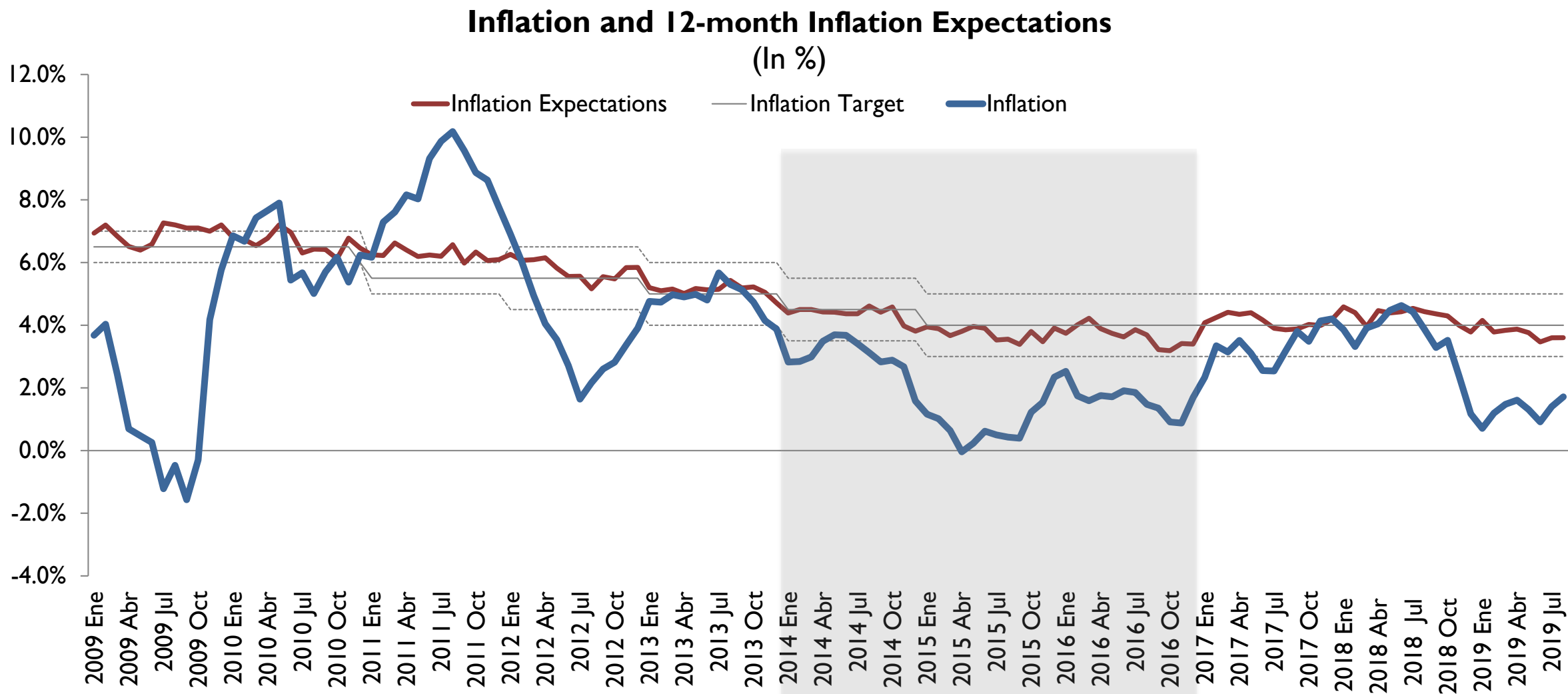


**MPR in Latin America  
(in basis points)**

Net commodity importers	$\Delta$ 2014-2016	Net commodity exporters	$\Delta$ 2014-2016
Dominican Republic	-1.25	Brasil	2.50
Costa Rica	-3.50	Chile	0.50
Guatemala	-1.00	Colombia	3.25
		Perú	0.75

...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.

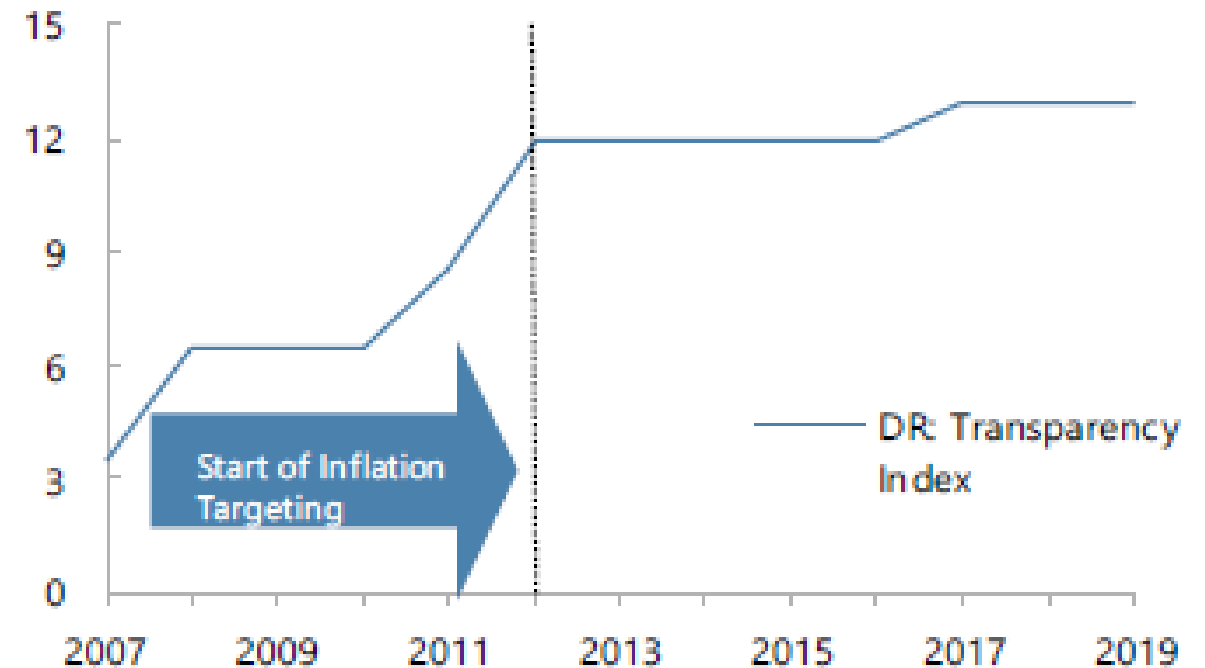


# These improvements in the communication Strategy have led to greater CB transparency...

## 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