Effects of Major Central Banks' Unorthodox Monetary Policies on Domestic Inflation

Nam, Min Ho*, Jeong, Jae Wook**, Kang, Gyu Hwi***

Along with the persistently low inflation around the world since the global financial crisis, domestic inflation has also remained at a very low level for several years. On the supply side, this is generally attributed to declines in international oil and commodity prices, which have persisted since 2012 due mainly to the global economic slowdown, while on the demand side, domestic economic sluggishness is seen as the primary factor. However, it also seems important to examine how the unorthodox monetary policies adopted by the US Federal Reserve and other major country central banks have affected domestic inflation. As global liquidity growth raised foreign capital inflows, lowering the Korean won's exchange rate, the falls in commodity and intermediate goods prices during the periods of quantitative easing might have increased downward pressure on inflation.

From this perspective, this study uses a VAR model to empirically examine how the unorthodox monetary policies of the four major central banks, including the US Fed, have affected domestic inflation from 2009 to 2014. An analysis of these central banks' securities holdings and long-term interest rates (yields on 10-year Treasuries), using exogenous variables reflecting the unorthodox monetary policies, shows that these policies have somewhat contributed to lowering domestic inflation further through the exchange rate channel. Quantitative easing and other unorthodox monetary policies by the US Fed, in particular, are estimated to have affected domestic inflation more significantly than the policies of other central banks.

These results suggest the great need for systemic studies on how various external factors, such as changes in the major countries' policy stances, affect

domestic inflation, which could then serve as the basis to strengthen communication regarding monetary policy. If a small open economy like Korea fails to accurately recognize and understand that domestic inflation has been amplified by external factors, economic agents may view domestic economic situations in an excessively negative light, which could lead to risks of unnecessary economic fluctuation.

* Economist, Monetary Credit & Policy Research Team, Monetary Policy Research Division, Monetary Policy Department (Tel: +82-2-759-4650, e-mail: minho@bok.or.kr)

** Economist, Policy Framework Research Team, Monetary Policy Research Division, Monetary Policy Department (Tel: +82-2-759-4407, e-mail: jaewookjeong@bok.or.kr)

*** Junior Economist, Monetary Credit & Policy Research Team, Monetary Policy Research Division, Monetary Policy Department (Tel: +82-2-759-4782, e-mail: gyuhwi@bok.or.kr)

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Ⅰ. Background

Ⅱ. Major Central Banks' Unorthodox Monetary Policies and Domestic Inflation

Ⅲ. Empirical Analysis

Ⅳ. Implications