

Summary of Session 2: Monetary Policy in the Age of Tariff and Supply Shocks

The Monetary Policy Session discussed the impact of supply shocks on inflation and growth, emphasizing the challenges central banks face in maintaining price stability. Key panelists included Mr. Bayodala from the Bank of Mongolia, Dr. Dong Chul Cho from the Korean Development Institute, Dr. Miroslav Singer from Generali CEE Holding, and Dr. Sonia Baskaya from the Adam Smith Business School. They highlighted the importance of credibility, communication, and understanding the nature of supply shocks. Specific examples included the 2007 oil price shock, the impact of tariffs on global GDP, and the role of fiscal policy in commodity-driven economies. The session concluded with a call for international cooperation and coordination to address these challenges.

Mr. Tuvshintugs Batdelger, as moderator, opened the session titled *"Monetary Policy in the Age of Tariff and Supply Shocks."* He introduced himself as a Professor at the Economic Center of the National University and Director of the Economic Research Institute. Using a textbook graph, he illustrated the economic impact of supply shocks and explained the short-run challenges monetary policy faces in responding to such disruptions.

Mr. Bayardavaa Bayarsaikhan followed with kickoff remarks that focused on defining supply shocks and explaining how they differ from demand shocks. He emphasized that supply shocks tend to push inflation higher while simultaneously dampening economic growth. He cited examples such as tariffs, energy disruptions, and weather-related events as key drivers of global supply shocks. Drawing on IMF research from 2023, Mr. Bayardavaa highlighted the particularly severe economic consequences of tariffs for low-income countries. He also reviewed the responses of central banks like the Federal Reserve and the European Central Bank, noting actions such as the Fed's increase in policy rates to around 5% in mid-2023. He underscored the importance of maintaining central banks' ability to prevent wage-price spirals and the critical role of forward guidance and communication in anchoring inflation expectations.

Dr. Dong Chul Cho discussed the role of macroeconomic policy in managing inflation and growth. He emphasized the importance of long-term inflation targeting and acknowledged the difficulties of short-term policy responses in volatile conditions. Dr. Cho also reflected on the dual mandate of the Bank of Korea, which includes financial stability, and the confusion it has sometimes caused in policy implementation. He stressed the need for central banks to remain committed to stabilizing inflation, especially in emerging markets, and highlighted the crucial role of building institutional credibility and ensuring clear communication with the public. In response to a question about the feasibility of inflation targeting in developing and commodity-driven economies, Dr. Cho noted that while challenging, it is achievable with a long-term agenda, a focus on credibility, and clear, consistent messaging.

Dr. Soner Baskaya addressed the shifting global economic outlook and the complexities of managing supply-side shocks. He emphasized the need for central banks to understand and differentiate between temporary and persistent disruptions to demand and supply. Dr. Baskaya argued that effective monetary policy requires a robust toolkit and an ability to adapt responses depending on the nature and duration of shocks. He also spoke about the limits of conventional rate hikes in open economies and advocated for

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capital flow management tools and fiscal coordination, including the establishment of stabilization funds. Throughout his remarks, he highlighted the essential role of communication in maintaining economic stability.

Dr. Miroslav Singer contributed with a case study from his tenure as Vice Governor of the Czech National Bank during the 2007 oil price shock. He described the series of external shocks faced by the Czech economy, including rising fuel prices and regulated price adjustments, and the central bank's measured response, which involved a modest interest rate increase and robust communication efforts. Dr. Singer shared five key takeaways for policymakers, emphasizing the need for credible, well-calibrated responses and clear communication strategies to maintain public confidence and policy effectiveness.

In the panel discussion that followed, Mr. Tuvshintugs Batdelger invited further comments on the importance of credibility and communication. Dr. Cho emphasized that both institutional and personal credibility are vital for central banks, particularly in countries with weak governance. He reiterated the importance of transparency and the need for central banks to clearly explain the rationale behind their decisions.

Mr. Bayardavaa Bayarsaikhan also addressed the specific challenges Mongolia faces in managing supply shocks, particularly those stemming from volatility in commodity prices and the effects of climate change. He noted the difficulties of implementing inflation targeting in an economy heavily influenced by fiscal dominance and underscored the importance of rapid and transparent communication to manage public expectations.

Finally, Dr. Baskaya concluded by highlighting that central banks must be equipped with a broad set of tools to manage complex environments characterized by supply shocks and fiscal dominance. He stressed that effective policy requires coordination with fiscal authorities, the development of stabilization mechanisms, and a constant focus on financial stability through clear and credible communication.

Key Insights:

- Supply shocks create complex challenges for monetary policy
- Inflation expectations are crucial in managing economic uncertainty
- Central banks must balance growth, inflation, and economic credibility

Critical Strategies:

1. Develop clear communication
2. Maintain policy flexibility
3. Anchor inflation expectations
4. Invest in robust economic analysis
5. Build institutional credibility

Emerging Market Challenges:

- Managing fiscal dominance
- Navigating frequent economic disruptions
- Implementing effective inflation targeting

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Primary Recommendation: Central banks must be adaptable, transparent, and focused on long-term economic stability while responding thoughtfully to short-term economic shocks.

Quotes from the session

Dr. Dong Chul Cho:

- "In the long run, inflation is going to be dictated by monetary policy."
- "Do what you say and say what you do. That's the key message for the Central Bank of inflation policy."

Dr. Miroslav Singer:

- "Be credible. Build it before the shock comes."
- "If it is doing nothing, do nothing in terms of monetary policy."
- "Do not think political support is granted."

Dr. Soner Baskaya:

- "The risk is, if you act without understanding the roots of the shocks, this may lead to suboptimal outcomes."
- "Keeping the credibility and keeping the expectations accurate is the key thing."
- "We need renewed multilateralism, not reduced."

Mr. Bayardavaa Bayarsaikhan:

- "In Mongolia, where climate extremes, price shocks, and fiscal pressures collide, the Central Bank must walk a tightrope—balancing inflation expectations, output gaps, and public demands—all while explaining the unseen battles it fights each day."
- "Central bank needs to raise the policy rate to demonstrate the commitment to control inflation and reinforce confidence."

General Insights:

- "Do what you say, say what you do." (Repeated theme across panelists)
- "Credibility is the key policy buffer against economic shocks."

- End -