Low rates are hurting developing countries, says Bank of Thailand head

Ultra-low or negative interest rates in Japan, the United States, and Europe placed a difficult burden on other central banks and may threaten their independence in the future.

Veerathai Santiprabhob, governor of the Bank of Thailand, told the annual conference of the Asia Development Bank Institute that, with interest rates low, central banks have taken to using macroprudential tools.

They are tinkering with regulations to affect the actions of markets, investors and consumers, and adjusting rules to control the flow of capital through their borders.

> We have talked a lot about the use of macroprudential tools and capital flow management measures. They might be appealing in, theory, but operationalizing them in practice has proven challenging because of limited experience by most central banks and also by the markets. We have to get a common understanding of this policy when we communicate with the market and the market needs to understand what central banks mean and the implications of such policies. Traditionally, we tended to see macroprudential tools as complementary to monetary policies. But these days, macroprudential tools are seen as instruments to offset the effects of too easy monetary policies as well as other government policies. Monetary policy, as we know, has been overburdened. There is also the possibility that macroprudential tools risk becoming overburdened as well.

Low interest rates have led to the growth of some dangerous financial trends in developing Asia, he says, with investors taking on some dubious risks as they search for investments that give them better returns.

Some institutions, which made promises based on expectations of higher rates, have been pushed to take on riskier investments.

> For financial institutions, particularly those that have committed liabilities, such as insurance companies and pension funds, the sustained low interest rates threaten their long-run viability and create the need for them to take on more risk.

Smaller investors have also taken on more risk, sometimes without even knowing it.

> At the depositor level, "search for yield" behavior has also been observed in a number of ways. We see the emergence of shadow banking in a number of emerging market countries, ranging from saving cooperatives to mutual funds. We also see asset-management companies producing mutual funds of assets consisting of nonrated instruments. Depositors are not aware of the risk involved and they cannot look through the cycle. The "search for yield" behavior among depositors could become a big concern in many emerging markets in Asia. There are too many people involved and, if such a collective investment scheme or saving cooperative goes under, it could have many implications.

The low-rate environment has also left central banks open to the potential for political fallout. Many central banks have purchased large amounts of assets such as government bonds to keep downward pressure on interest rates, and they could see losses on those assets once rates rise again.

> Central banks' large holdings of securities could imply significant losses when interest rates start to normalize. This could open central banks up to increased political pressure, particularly for central banks that need to be recapitalized to compensate for the losses. It is also a perception that monetary ease hurts savers and retirees while boosting asset prices that benefit banks and wealthy asset holders. This could be a flash point given growing popular discontent against the establishment amid rising income inequality. Central bank legitimacy and central bank independence rest on the popular support of the people and should not be taken for granted.

That was Veerathai Santiprabhob, governor of the Bank of Thailand, speaking at the annual conference of the Asian Development Bank Institute, on The Side Effects of Ultra-Low and Negative Interest Rates in Asia and Their Implications for Emerging Market Economies.

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