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Central Banks Should Form Panel on 'Spillover' Risk, Report Says

By Simon Kennedy - Sep 13, 2011

Central banks should take greater account of the effect their monetary policies have abroad and meet regularly to discuss spillover risks, according to a study by economists including Mohamed El-Erian of Pacific Investment Management Co. and Gavea Investimentos' Arminio Fraga.

In a report published today by the Washington-based [Brookings Institution](#), the economists proposed an International Monetary Policy Committee to identify the unintended threats a policy decision made in one economy poses to another. Large- economy central banks should also pay more attention to the global implications of their decisions, the study said.

"Where appropriate, they should consider coordinated action to help stabilize the global economy in times of stress," the report said.

The study reflects mounting concern that the choices of central banks increasingly carry implications for foreign economies. Brazilian Finance Minister [Guido Mantega](#) said a year ago, for example, that a "currency war" was under way as low [interest rates](#) in rich nations and China's policy of controlling the yuan led investors to push capital into economies such as his, encouraging overvalued exchange rates and asset inflation.

While central bankers already meet regularly at meetings of the [International Monetary Fund](#) and Bank for International Settlements, the Brookings report said its proposed committee would allow spillovers and coordination to be "discussed explicitly." The panel should issue a report to world leaders assessing and justifying their policies from the perspective of the world economy, pointing out areas of dissent or inconsistency, it said.

'Inconsistencies'

"The need to issue periodic public reports can help central bankers identify and publicly air the inconsistencies in their policies," the report said. "With time, this should encourage them to internalize some of the external consequences of their policies."

The Brookings study said central banks should also twin their traditional focus on low inflation with an explicit goal of financial stability and make clear that monetary policies can only be effective when they work in tandem with fiscal, regulatory and structural policies.

Other authors of the report included former IMF economists Eswar Prasad, [Carmen Reinhart](#), [Kenneth Rogoff](#) and [Raghuram Rajan](#).

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