MONETARY RESPONSE TO OIL PRICE SHOCK IN THE ASIAN COUNTRIES: DOES MONETARY REGIME MATTER?

ISHIKA KATARUKA

ABSTRACT

This paper intends to investigate the monetary response to oil price fluctuation along with comparative study of monetary regime (Inflation targeting (IT) and Exchange rate Targeting (ERT)) for 10 Asian oil importing Emerging and Low-income countries in dynamic panel model framework. The study is based on annual data from 2000-2018. We augmented the long run Taylor type rule with real oil price and run two models for Inflation targeting and Exchange targeting monetary regime.We employ estimators that allows for heterogeneity across countries as well as produces heteroscedastic- and autocorrelation-consistent standard errors which are efficient and robust to cross sectional dependence. Interestingly, we find that crude oil prices are negatively related to the interest rates set by the Central banks(CBs) of these Asian economies. This is an indication that the demand channel of transmission of oil price fluctuations have been overshadowing the supply channel of transmission. Therefore, CBs lowered interest rates to cushion the recessionary impact. Our results also reveal that, in the IT regime, CBs proactively react to oil price fluctuations unlike in the ERT regime. This asserts the efficacy of the IT regime in terms of absorbing oil shocks.

Keywords: crude, monetary policy, Monetary Regime, Policy rate, Asia countries, dynamic panel data model, Pooled Regression, Inflation Targeting