

The BIS and central banking over the past two decades

Colloquium in honour of Claudio Borio

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It is a great pleasure to be back in Basel at the BIS. I have been travelling to Basel for 30 years and, given the distance between Sydney and Switzerland, I suspect I hold the record for the most hours in a plane to attend meetings at the BIS. Over all those years visiting Basel, there have been a couple of constants – great hospitality by the BIS and chatting to Claudio.

I have had the privilege of chatting to Claudio in many different capacities: as a young researcher early in my career, as an economist on the BIS staff working to Claudio (2000–02), as Governor of the Reserve Bank of Australia, as chair of the Committee of the Global Financial System – and, most importantly, as my friend.

Over those three decades. I learnt that Claudio is relentlessly inquisitive, dogged in pursuing ideas – even if they are unpopular – prolific in his output, and that he has a strong desire to collaborate. He has been a great mentor to many, including myself, and has always been willing to listen and understand other people's perspectives. He also cares greatly about the people around him and has a deep sense of commitment to the central bank community. For all these reasons and more, the BIS community will miss Claudio greatly.

This session focuses on the role of the BIS and central banks. I have long thought of the BIS as having a couple of broad roles.

The first is to support the central bank community, including through helping central banks talk to one another and to coordinate. Everybody would agree with that.

The second role, as I see it, is to challenge the central bank community. This is more controversial, and I know not everyone would agree with this.

Central banks can be insular organisations and, left to themselves, it can sometimes feel like a bit of an echo chamber. So, I often felt that in our meetings we needed to be challenged from time to time. The academic community can do this, but sometimes they speak a slightly different language, and it can be hard to translate some ideas into the practical world of policymaking, with all its constraints. In contrast, the BIS knows our language, it knows that policymaking can be hard and it knows what is troubling central banks. And it can be trusted and has a global perspective.

This means that the BIS can challenge and provoke the central banks in a constructive way. I know this can be uncomfortable for BIS management; it's perfectly reasonable to be apprehensive about provoking the institutions that are your shareholders and your customers. But I always thought the BIS was at its best when

it found a way to do that. I didn't want to travel halfway around world sit in an echo chamber – I could have done that in Sydney. I travelled to the BIS because I wanted to be stimulated and, sometimes, provoked.

Over the past 30 years, Claudio has been instrumental to the BIS performing both of the broad roles that I just spoke about – supporting the central bank community with the bread-and-butter issues and challenging and provoking us to think differently about issues.

I want to spend some time focusing on how Claudio challenged us, but much of his work has been in supporting the bread and butter of central banking. Claudio's writings on topics including central bank operating procedures, the importance of clear central bank mandates and trends in financial markets were required reading for most central banks. So too were Claudio's many essays setting out frameworks for thinking about issues. Claudio was also a strong supporter of the BIS's work in Asia. His visits to the region were eagerly anticipated and played an important role in advancing central banking in the region.

But I want to focus on the areas where Claudio challenged us – and where his thought leadership was invaluable.

Claudio wasn't afraid to put controversial ideas to paper. Some of these ideas have now moved close to the mainstream, although others still provoke some controversy. Some examples, without the usual caveats that Claudio would invariably and diplomatically include:

- Prudential supervisors are too focused on the micro, and need to augment this with a macro focus.
- Monetary policy can't ignore financial stability issues, especially the build-up of financial imbalances.
- There is a financial cycle, as well as a business cycle, and the financial cycle is increasingly driving economic dynamics.
- There are diminishing returns from easing monetary policy and increasing risks, so be very careful.
- Monetary policy decisions can have long-lasting effects on the equilibrium real rate of interest, so be super careful.
- Domestic inflation can become insensitive to monetary policy easing.
- Monetary policy horizons can be too short – central banks need to look over the two-year horizon.

Of these various ideas, the ones that I am most familiar with are the ideas about macroprudential policy and monetary policy and financial stability.

Claudio and I were writing about this set of issues in the early 2000s. There was a lot of pushback from parts of the central bank community. I recall sitting in meetings where senior officials were saying things like: "You don't have a theoretical framework. This stuff is just rubbish." Some central banks would go on to say that if you publish this stuff, you will just make our lives harder – the BIS should be helping us, not hurting us or interfering. These central banks didn't appreciate the challenge to the orthodoxy: micro supervisors should stick to the micro and enforcing the rule book; two years was the right horizon for the inflation target; and the build-up of financial balances was not a first-order issue for monetary policy – prudential policy should protect the system from these.

Yet Claudio was relentless, and he kept pushing forward. He did that with the strong support of Andrew Crockett, the General Manager at the time – who to his great credit navigated the complaints of some central banks who would have preferred Andrew to stop this work.

Twenty-five years on, some of Claudio's ideas remain controversial, but many do not.

Macroprudential is no longer a dirty word. Many countries now have established macroprudential policymakers, and toolkits have been developed. Most inflation targets now have a degree of flexibility, and no longer have a sharp focus on the two-year horizon. And many central banks now take financial stability issues seriously when setting interest rates.

This is quite a change. Claudio helped drive this change by challenging and provoking us. It's true to say that he annoyed some central banks sometimes, although his work found strong support in other central banks, particularly in Asia. But even the central banks he annoyed always listened to what he had to say. They did that because Claudio always spoke with a great deal of basic common sense, his drafting was always excellent, he always recognised the alternative arguments and the central banks knew that he really understood central banking.

Thank you, Claudio. We have all learnt a lot from you over the past three decades, and monetary economics is in a better place for your thought leadership.

I am proud to have had you as my boss and my friend.