Discussion of Borio

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Opening

- Thank you for inviting me.
- I have known Claudio for over 20 years, in which he has influenced every facet of my thinking on money and banking. Interestingly, Claudio, despite being intensely curious and innovative, the hallmarks of a true academic, largely does not write for the mainstream academic journals.
- Instead, you have to follow his contributions and ideas in literally hundreds of very well cited policy papers and speeches.
- Let me speculate why he made this choice.
- It is not surprising that central bank research departments rarely contradict the policy choices of their own central banks. And, of course, for them to criticise the policy choices of other central banks would be frightfully impolite. As Phil Lowe and Otmar Issing said in the previous panel, this instills an element of group think.

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- This is where Claudio and the BIS research department have built a most important niche. They speak to their captive audience of central bankers, even while addressing the world.
- Specifically, they question what central banks are doing, with greater knowledge and credibility than the ordinary academic. Their research has been pathbreaking and its influence very meaningful over time.
- So why write for academic journals, where group think also ensures it is hard to publish, when you can have so much more fulfilment tilting against central bankers? Claudio picked influence over academic status.
- What Claudio has done requires academic smarts of course, but also courage and tact – after all, you are questioning your organisation's biggest customers – and perseverance – central banks will take time to admit you are right, if they ever do.
- So let me salute Claudio, the BIS research department and a sequence of supportive General Managers of the BIS to this day for the yeoman service they have provided the world.

The separation principle

- As the last speaker, let me raise one issue on which Claudio has been unsuccessful in persuasion.
- That is, getting central bankers to abandon the "separation principle", the notion that monetary policy concerns and financial stability concerns are separable, and should be tackled by different instruments, even committees.
- In a pathbreaking paper with Philip Lowe in 2002, Claudio contradicted the then emerging Fed view that it was hard to identify the sources of emerging instability, and it was better for monetary policy to pick up the pieces rather than lean against the wind.
- Let me read the abstract to the paper, which exemplifies everything I have been saying about the BIS.

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- I quote
- “This paper argues that financial imbalances can build up in a low inflation environment and that in some circumstances it is appropriate for policy to respond to contain these imbalances.
- While identifying financial imbalances ex ante can be difficult [aside: this is the tact part, nodding to Fed wisdom], this paper presents empirical evidence that it is not impossible.
- In particular, sustained rapid credit growth combined with large increases in asset prices appears to increase the probability of an episode of financial instability.” [aside: this is the finding that launched a thousand papers]
- The paper also argues that while low and stable inflation promotes financial stability, it also increases the likelihood that excess demand pressures show up first in credit aggregates and asset prices, rather than in goods and services prices.
- “Accordingly, in some situations, a monetary response to credit and asset markets may be appropriate to preserve both financial and monetary stability.” [This is the bold policy part, going against separation]
- End quote

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- I wish the Fed had taken Claudio’s policy advice in 2002, we may not have had the GFC.
- Unfortunately, central bankers still resist, despite growing evidence that financial instability follows tightening of extremely accommodative monetary policy.
- A first effort was to argue that it is best to use macroprudential instruments rather than monetary policy to tackle financial stability. But that is like pressing on the car’s accelerator while trying to slow it down by waving your hand outside the window.
- A second effort was to claim that leaning against the wind with monetary policy would do little for financial stability, while harming inflation control and growth. Claudio wrote a paper showing that with sensible assumptions, it would be beneficial on net.

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- In recent years, he has been arguing that central bankers' holy grail, r*, is endogenous and influenced by the interaction between monetary policy and financial stability.
- All this to no avail.
- Indeed, after the failures in the US banking system in 2023, the emergence of 22 bank runs at the time of SVB's failure, extensive emergency lending by the Fed and the Federal Home Loan Banks, and effective conversion of all uninsured deposits to insured, the Barr post mortem focused on supervision and bank management as root causes with no mention of monetary policy.
- You might think that quantitative easing had something to do with the pile up in uninsured deposits at SVB. Yet research now claims that balance sheet expansion and contraction have no adverse effects. What about the largest banking failures in nominal terms in US bank history?
- So Claudio's work is not finished, and will hopefully be carried on by the next generation at the BIS. All I can say is that for everything you have done, thank you!