

Claudio Borio's contribution to the central bank community

Colloquium in honour of Claudio Borio

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Today, let me talk about Claudio Borio's contribution to the central bank community as well as the role of the BIS in central bank cooperation.

I got acquainted with Claudio in 1997, when I became a member of the Euro-currency Standing Committee, which was later renamed the Committee on the Global Financial System. Claudio was a member of the secretariat of this Committee. Ever since, we have been good friends and spent countless hours discussing many issues around central banking.

Claudio's arguments and ideas were, to say the least, profoundly inspiring and greatly encouraging, not only in my days as a staff member of the Bank of Japan but also in my days as Governor. The main reason was that his views strongly resonated with what the Bank of Japan was tackling during those years. I think people in this room will remember how the Japanese economy and the Bank of Japan's monetary policy were then discussed by mainstream academics. Their argument can be summarized in the following three propositions:

- First, deflation is the primary cause of low growth in Japan.
- Second, deflation is a monetary phenomenon and thus the central bank can defeat it.
- Third, the Bank of Japan should adopt more aggressive monetary policy.

The Bank of Japan was fiercely criticised and sometimes mocked by those academics. The central bank community was more diplomatic, but questions raised were more or less similar to the above argument. I felt that the critics were missing the real issues faced by the Bank of Japan at both intellectual and practical levels.

There were, however, a few exceptions. For example, BIS people such as Andrew Crockett, Bill White and Claudio Borio were most notable for their willingness to challenge the conventional wisdom in their remarks and papers. They were pushing to carefully assess the true causes of inflation dynamics, to distinguish between cyclical and structural developments and to assess the impact of the financial cycle on monetary policy. Their views were not taken seriously until the Great Financial Crisis (GFC) hit.

This situation changed somewhat after the GFC. People finally recognised what Claudio was talking about. We have seen, at least until the Covid-19 crisis, a growing debate on so-called "Japanification" in many advanced economies. The Japanese experience should be understood within a common intellectual framework.

In this spirit, I want to draw your attention to the following four issues, some often raised by Claudio:

- First, Japan's massive bubble economy raised its ugly head amid perfectly low inflation. Interestingly, Japan had achieved low inflation long before many countries achieved it by adopting inflation targeting. This begs the question: "Is price stability enough?"
- Second, Japan has experienced very mild deflation since 1998. But its growth rate was decent during the period, if we adjust for the impact of the concurrent decline in the working age population. This begs the question: "Is deflation the real bogeyman?"
- Third, although Japan adopted all kinds of aggressive monetary easing measures, inflation did not respond at all, and growth did not accelerate. This begs the questions: "Is unconventional monetary easing effective?" And "In what sense can the central bank become the anchor for price stability?"
- Fourth, although the usual justification for a 2% target is a need to have a safety margin for not slipping into the zero lower bound of interest rates, at the end of the day, almost all advanced economies lost the safety margin. This begs the question: "Does the logic of the prevailing intellectual model of monetary policy make sense?"

Answering these questions essentially boils down to rethinking the inflation targeting framework and the validity of the intellectual model supporting this framework. In this respect, Claudio has made great contributions by writing so many stimulating papers. I respect his intellectual integrity and admire his courage.

This leads me to my second topic on the role of the BIS in central bank cooperation. In the interest of time, I would like to focus on just one invaluable contribution.

That is what I would call the BIS as "a lighthouse" or "a guiding light." A case in point is a series of speeches and papers by management and staff, which I mentioned earlier. The views expressed by the BIS were sometimes at odds with the mainstream views of academics and the policy orientation of major central banks.

In this respect, I believe that the biggest challenge facing central banks in the decades to come is the rethinking of inflation targeting framework. It was a success; but at the same time, it became evident that it had shortcomings, such as the shortening of the time horizon and the neglect of important low-frequency events and the complex and potentially harmful interactions between monetary policy and structural issues. The need for rethinking is very clear. Claudio has given us some hints such as in his recent speech in London and the discussions in recent BIS Annual Economic Reports.

Unfortunately, the appetite of central banks to take up the challenge does not seem to be large. I suspect it is either because central banks fear it could lead to opening Pandora's box or they feel an alternative framework is too elusive. On top of that, central banks are understandably reluctant to admit shortcomings in the existing framework.

Enthusiasm from academics and private sector economists is also lacking. As many of the most influential members now often have experience sitting on central bank policy boards, and as the population of former central bank economists increases, there seems to be fewer and fewer experts who are willing to challenge the official views of central banks. I am afraid that a kind of groupthink would prevail at the societal level.

It is for this reason that the role of the BIS as a lighthouse becomes so important. Of course, considering that the BIS itself is owned by member central banks, there might be issues of "house views" and communication. However, given the important role that central banks have come to play, I hope the BIS will continue to be our lighthouse in the decades to come.