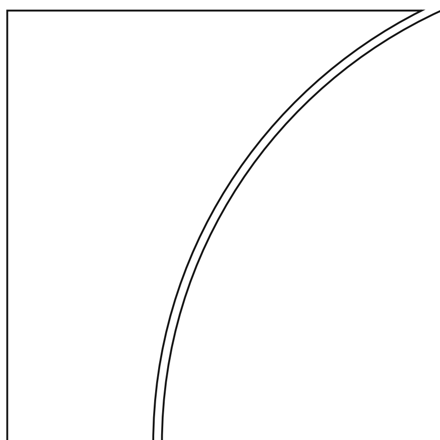

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Navigating uncharted waters: opportunities and risks for central banks

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Foreword

The 23rd BIS Annual Conference took place in Basel, Switzerland, on 28 June 2024. The event brought together a distinguished group of central bank Governors, leading academics and former public officials to exchange views on the theme "Navigating uncharted waters: opportunities and risks for central banks". The papers presented at the conference are released as BIS Working Papers, nos 1222, 1223, 1224 and 1225.

BIS Paper no 150 contains remarks from the closing panel on "Revisiting the last decade of monetary policy", by Michele Bullock (Reserve Bank of Australia), Pablo Hernández de Cos (Bank of Spain), Thomas Jordan (Swiss National Bank) and Sethaput Suthiwartnarueput (Bank of Thailand).

Programme, 28 June 2024

9:00–9:05	**Welcome**	**Hyun Song Shin**, Bank for International Settlements
9:05–10:20	**Session 1: Opportunities and risks from artificial intelligence for central banks**	
	Chair	**Lesetja Kganyago**, South African Reserve Bank
	Speaker	**Ralph S J Koijen**, University of Chicago Booth School of Business
	Discussants	**Tania Babina**, Columbia Business School
		Hyun Song Shin, Bank for International Settlements
10:45–12:00	**Session 2: Sustainable investment in green finance**	
	Chair	**Julio Velarde**, Central Reserve Bank of Peru
	Speaker	**José A Scheinkman**, Columbia University
	Discussants	**Tobias Adrian**, International Monetary Fund
		Mariassunta Giannetti, Stockholm School of Economics
13:30–14:45	**Session 3: Geopolitics and the macroeconomy**	
	Chair	**Chang Yong Rhee**, Bank of Korea
	Speaker	**Matteo Maggiori**, Stanford Graduate School of Business
	Discussants	**Javier Bianchi**, Federal Reserve Bank of Minneapolis, University of Minnesota
		Kristin Forbes, MIT Sloan School of Management
14:45–16:00	**Session 4: Monetary policy in the post-Covid environment**	
	Chair	**Tiff Macklem**, Bank of Canada
	Speaker	**Silvana Tenreyro**, London School of Economics and Political Science
	Discussants	**Agnès Bénassy-Quéré**, Bank of France
		Raghuram Rajan, University of Chicago Booth School of Business
16:30–17:45	**Closing panel: Revisiting the last decade of monetary policy**	
	Moderator	**Agustín Carstens**, Bank for International Settlements
	Panellists	**Michele Bullock**, Reserve Bank of Australia
		Pablo Hernández de Cos, Bank of Spain
		Thomas Jordan, Swiss National Bank
		Sethaput Suthiwartnarueput, Bank of Thailand

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Panel on "Revisiting the last decade of monetary policy"

Remarks by Michele Bullock

Michele Bullock, Governor, Reserve Bank of Australia

Thank you Agustín.

As we have heard, it has been a tumultuous decade for central bankers – an extended period of below target inflation following the Great Financial Crisis (GFC), a global pandemic, large and numerous supply shocks, and the current period of high and persistent inflation. My remarks will touch on four lessons that have come from the experiences of the past decade (and longer as Agustín has rightly pointed out) and highlight some live issues that the Reserve Bank of Australia (RBA) is currently working through following our recent Review.

The first point that is worth making is that inflation targeting has served us well despite the challenges that have been served up to us as a small open economy over the past 15 years. The Australian economy has benefited greatly from international trade and being closely integrated with global capital markets. But this openness also means that the domestic economy is affected by shifts in international conditions. One example of this was the post-GFC period, when there was a large increase in the terms of trade, which led to an increase in inflation in Australia (though the monetary policy response was partly mitigated by an appreciation in the exchange rate).

As that terms of trade shock wore off, Australia faced a similar environment to other countries. Inflation was too low and we found it difficult to get inflation up, even with what was then unusually low interest rates. Of course, other central banks also had unusually low interest rates.

And echoing some comments earlier, the need to better understand the supply side has become more important in the post-pandemic era. Our models didn't incorporate the supply side very well, and like other central banks, we initially found it difficult to distinguish supply from demand impacts.

Throughout all the challenges over the past few decades, the flexible inflation targeting framework has served Australia well. Inflation has, on average, met the target of 2–3%, and the variability of output and unemployment has been lower than in earlier decades. The recent Review of the RBA endorsed this framework, and I'll come back to that a bit later on.

The second point is that we have learned a lot about the benefits and costs of unconventional monetary policy tools. During the Covid-19 pandemic the RBA deployed a package of these tools for the first time, in addition to decreasing the cash rate to 0.1%. These tools included a yield target for three-year government bonds, a three-year term funding facility for banks, quantitative easing (QE) and forward guidance.

Overall, our view is that the package of measures was effective in supporting the economy through the pandemic, by lowering the cost of funding for businesses and

households. Nevertheless, we found some challenges with these tools that would be familiar to many of you. Our forward guidance became time-based guidance rather than state-based guidance. While there were qualifications around the time-based guidance, these were not emphasised enough, and there was some reputational damage when our subsequent tightening was viewed as inconsistent with our guidance.

The yield target worked well to ease financial conditions but had limited flexibility to respond to a changing economic environment and therefore resulted in a disorderly exit. The bond purchase program offered more flexibility in terms of exiting, but long-term rates do not affect financial conditions in Australia to the same extent as in other countries, as most mortgages are variable rate. The Term Funding Facility was also effective in easing financial conditions, but it is worth noting that like at other central banks, both the Term Funding Facility and QE exposed the RBA to interest rate risk and resulted in large losses and negative equity. An important note is that the cash rate is the most effective way of influencing financial conditions when away from the effective lower bound.

The third point is around coordination with other policy arms. The Review of the RBA called for improved coordination with macroprudential policy and fiscal policy. Australia has a strong financial system. There were, however, some challenges pre-pandemic with a combination of high household debt, a rapid increase in house prices and easing monetary policy. In particular, there was a concern that by lowering interest rates in response to inflation being below target, we were fuelling an unsustainable increase in debt. As a result, the Australian Prudential Regulation Authority (APRA), with the support of the RBA, dipped its toe into the macroprudential toolkit. The RBA has long had a financial stability mandate and has a close working relationship with APRA. But, as urged by the recent Review, this relationship is going to be given more formal structures to better support policy coordination. One of the goals in doing so is to provide monetary policy with greater flexibility to achieve economic outcomes while mitigating potential unintended consequences for financial stability.

On coordination with fiscal policy, this is a challenging area. Central bank independence does not mean monetary and fiscal policy have to be set in isolation, and the Review called on the Reserve Bank and Treasury to do some joint work on this. However, it's all very well to say that fiscal policy and monetary policy should work together, but this is difficult to achieve in practice. As one example, governments have a lot of objectives when setting fiscal policy, not just inflation. This means that it can be challenging to coordinate monetary and fiscal policy.

Finally, let me make a few comments on transparency and communication. Independence means we need to be accountable. One way of helping to achieve accountability is having regular reviews of the central bank. But for the RBA, the recent Review was the first one in a long time, and so the plan is to have more regular reviews going forward, perhaps every five years.

There is also a real challenge in communicating that will be familiar to all of us. Central banks need to be forward looking, make some tough judgments and weigh trade-offs. As we've heard here today in various sessions, this is complex and uncertain. That is very difficult to convey to a wide range of audiences. In Australia, this is sometimes made more difficult by the fact that most mortgages are variable

rate. Interest rate increases therefore have a very direct and immediate impact on many households. This was one reason why there was reputational damage when interest rates were increased in 2022, well before what households had expected based on interpretation of the RBA's time-based forward guidance.

Another difficulty in central bank communication is the distributional effect of monetary policy. Monetary policy is a blunt instrument, and I hear a lot from people in Australia about how interest rate increases punish people who have mortgages, while those who have savings (typically older people) are benefitting. This makes it all the more important to focus on communication and get across the message that inflation is bad and is damaging to all households. So I think I'll stop there.

Remarks by Pablo Hernández de Cos

Pablo Hernández de Cos, Former Governor, Bank of Spain

When analysing the potential lessons from the last decade of monetary policymaking, I take as a starting point the conclusions of the 2021 monetary policy strategy review of the European Central Bank (ECB), which took stock of the previous 15 years, and set those conclusions against the experience of the most recent inflationary/deflationary period in the euro area.

I will first briefly summarise the 2021 ECB strategy review in six conclusions:

1. The macro context of the previous decade had been characterised by a prolonged period of below-target inflation and low r-star because of low productivity, demographics and the consequences of the Great Financial Crisis. In this context, a major monetary policy concern was the risk of interest rates hitting the lower bound frequently.
2. Price stability was defined as a 2% symmetric inflation target over the medium term. Symmetry should be understood as both negative and positive deviations from 2% being equally undesirable. Thus 2% cannot be taken as a ceiling. The medium-term orientation allows for lags and uncertainty in the transmission of monetary policy and for the origin, magnitude and persistence of the shocks hitting the economy to be taken into account.
3. When the economy is close to the lower bound, this symmetry requires especially forceful or persistent monetary policy measures to avoid negative deviations from the inflation target becoming entrenched. This may also imply a transitory period in which inflation is moderately above target.
4. With regard to monetary policy tools, interest rates are the primary instrument, but, in recognition of the lower bound, the use of forward guidance, quantitative easing (QE) and long-term refinancing operations is considered appropriate.
5. Financial stability is considered a precondition for price stability. Thus, financial stability considerations should be taken into account in monetary policy deliberations. In practical terms, this means that an integrated framework of economic analysis and monetary and financial analyses is used to measure developments in financial vulnerabilities and macroprudential measures and their impact on output and inflation, including in the long run.
6. The interaction between monetary policy and fiscal policy is considered important. In particular, countercyclical fiscal policy could be particularly effective in the proximity of the lower bound.

On the basis of the experience of recent years, with the highest and longest inflationary episode in the euro area's history, the previous conclusions could be seen as follows.

As regards the **macro context**, the most recent period has been characterised by the presence of significant negative supply shocks and a very high level of uncertainty. Together with excess demand after the pandemic, this has led to very

high and persistent inflation. This is indeed a very different context from the one prevailing before the 2021 review.

A first conclusion could be that any monetary policy strategy should be robust to different scenarios since macro conditions can change suddenly and unexpectedly. Moreover, we have to prepare our analytical toolkit for a context of high uncertainty and the prevalence of significant supply shocks, due, for example, to geopolitical and climate events.

In such a context, a risk management approach is crucial. And this requires pragmatism, flexibility and judgment.

In practical terms, this means that, when making decisions, it is critical to be equipped not only with a baseline scenario but also with alternative scenarios that simulate different paths for the assumptions underlying the baseline scenario.

It is also necessary to improve our forecasting capabilities, including the possibility of non- linearities in the presence of important shocks, due to, for example, firms updating their prices more quickly.

The prevalence of high uncertainty is also relevant for the use of r-star in monetary policy decisions. Estimates for nominal natural interest rates are now in the range of between 1.5 and 3% for the euro area, and each of these point estimates comes with a significant margin of error.

The question is therefore how to conduct monetary policy when estimates of r-star (the real natural rate of interest) are subject to high uncertainty. The available economic literature concludes that, in such a context, the policy rate should be inertial, in the sense that the previous rate should serve as the primary reference point, with adjustments made based on inflation and output gaps. This approach not only mitigates the impact of estimation errors but also advocates for gradual adjustments in the policy rates, driven solely by estimated gaps, thereby promoting a data-dependent approach.

In this regard, I consider that the symmetric, medium-term 2% **inflation target** has been key to keeping inflation expectations anchored during the inflationary episode. However, anchoring inflation expectations has also required forceful action. Indeed, the most recent monetary policy tightening has been exceptional in terms of both its size and speed. This potential need for forceful action was recognised in the 2021 review when it concluded that “it is important for monetary policy to respond forcefully to large, sustained deviations of inflation from the target in either direction”.

All in all, in my view, the recent inflationary episodes vividly illustrate the crucial importance for central banks of acting and communicating in a way that keeps inflation expectations well anchored to their objectives in the face of inflationary shocks.

In this regard, a striking feature of this episode is that the disinflation process has taken place without a major loss of economic activity. There are two possible reasons why the sacrifice ratio has so far been so low.

First, the severity of the output-inflation trade-off crucially depends on inflation expectations. A rise in inflation expectations shifts the relationship between the short-term output gap and inflation upwards. In the case of the most recent inflationary

episode, inflation expectations over medium- and long-term horizons have remained broadly anchored.

Second, the output-inflation trade-off also depends on the slope of this relationship, ie how much output has to fall to bring inflation down (for given inflation expectations). In the basic New Keynesian model, this slope is steeper the higher the frequency with which firms adjust their prices to changes in their cost and demand conditions.

One consequence of the recent episode of high inflation was that firms changed their prices more frequently, accelerating the transmission of shocks to inflation. But by the same token, faster repricing by firms means that inflation is more sensitive to changes in aggregate demand. In other words, the Phillips curve becomes steeper, allowing the central bank to achieve the same reduction in inflation with smaller output losses.

The optimal monetary policy prescription in this situation is that the central bank should “strike while the iron is hot”, in other words, fight inflation by countering firms’ inflationary aspirations, thereby achieving a lower sacrifice ratio.

On **monetary policy instruments**, the evidence accumulated shows that the unprecedented scale and speed of the most recent **interest rate** hiking cycle in a context of adverse supply shocks, weak growth and high uncertainty appear to have contributed to amplifying the tightening of financing conditions. This has particularly been the case with credit developments, since the observed slowdown in credit flows has been sharper than predicted by linear models based on historical patterns.

However, there is also evidence that the strong growth in nominal income, in a context of robust employment and profit growth, has slowed the increase in the percentage of vulnerable indebted households and firms. As a result, the deterioration in credit risk has fallen short of what would be expected on the basis of historical regularities.

The evidence of the transmission from financing conditions to activity and inflation is more mixed. We have overestimated growth, and these downward surprises do not seem to be fully explained by errors in the technical assumptions, including the changes in the fiscal and monetary policy stance. This evidence might be signalling a stronger transmission of monetary policy to macroeconomic variables than in the past. On the other hand, the labour market has demonstrated remarkable resilience, as illustrated by lower than expected unemployment rates compared with projections.

As for the experience with **quantitative tightening** (QT), a gradual and predictive approach has reduced its negative and unwarranted effects. The fact that it has been implemented in relatively benign market conditions has also been crucial to this outcome. At the same time, the experience of central banks that faced bumps in the road to balance sheet normalisation shows that temporary flexibility in its implementation can be useful in managing liquidity events without reversing the medium-term path of QT.

Moreover, as excess liquidity in the system decreases alongside central banks’ balance sheet run-off, it will also be important to monitor market developments and analyse which investor types are absorbing the increased supply of bonds. Likewise, it will be essential to ensure that reserves remain ample at the endpoint of the QT

process, as otherwise the impact of QT may be larger and the risk of liquidity events may increase.

Turning to **forward guidance**, the rapid reversal of the macro context and the required policy response points to the need to accompany forward guidance with conditionality elements. Thus, clear communication that a certain forward guidance on rates or QE hinges on the prevalence of a certain inflationary outlook is of the essence. This could include providing well defined, state-contingent thresholds. Unconditional forward guidance should therefore be avoided.

Moreover, the conclusions reached in the 2021 review to explicitly take **financial stability** considerations into account in monetary policy deliberations remain, in my view, valid. This does not mean that monetary policy will consist of systematic policies of "leaning against the wind" (whereby monetary policy is systematically tightened when systemic risk builds up) or of "cleaning" (whereby monetary policy is systematically loosened when systemic risk materialises). It is instead a flexible approach.

In this regard, in normal times, the separation principle generally holds true. In stressed conditions in which a deflationary demand shock is present, financial stability risks might also materialise in a manner that does not create a trade-off with monetary policy. A case in point is the monetary policy response during the Covid-19 pandemic. The pandemic emergency purchase programme was the right tool to face a deflationary shock and, in parallel, avoid fragmentation and guarantee financial stability.

But even if liquidity crises occur in high-inflation periods, tools can be skilfully designed to ensure separation. To this end, the tools must be targeted and temporary, and the underlying financial stability challenge must truly be one of liquidity rather than solvency. The intervention by the Bank of England in autumn 2022 to stabilise the gilt market is one good example of such an action. The announcement of the Transmission Protection Instrument in July 2022 was also crucial to ensuring the smooth functioning of financial markets needed to transmit the tighter monetary policy stance.

But there may be cases in which there is a trade-off between the two objectives, for instance, when solvency issues emerge in the banking sector in a high-inflation environment. These solvency issues can be mitigated by a proper supervision and resolution framework and by the action of fiscal authorities. Nonetheless, monetary policy will have to react by taking into account that a financial crisis is likely to lead to the emergence of disinflationary forces that should ease this trade-off between monetary and financial stability over time, albeit at a potentially high cost in terms of output loss.

Finally, as regards the interactions between monetary and **fiscal policy**, the Covid-19 pandemic clearly demonstrated that fiscal and monetary policy could be complementary. However, as we emerged from the pandemic and the inflationary shock took hold, monetary and fiscal policies increasingly risked pulling in opposite directions, becoming less effective in the process. An important lesson in this regard is that monetary and fiscal policies are more effective when their stances are mutually supportive.

And this also means that, in a context of much higher public debt levels and also higher interest rates, fiscal policies should adopt a medium-term perspective to reinforce commitment to public debt sustainability and increase the fiscal space available to deal with future crises.

Remarks by Thomas Jordan

Thomas Jordan, Chairman of the Governing Board, Swiss National Bank

I would like to thank Agustín Carstens and the Bank for International Settlements (BIS) for inviting me to the 23rd BIS Annual Conference. It is a great pleasure to take part in this distinguished panel. The last decade has been a remarkable period for central banks. In my comments today, I will first look back at the monetary policy challenges that the Swiss National Bank (SNB) has faced over the last decade. Then, I will touch on three lessons from these challenges in terms of maintaining price stability. Thereby, I will take the perspective of Switzerland, a small open economy with a safe-haven currency.

Monetary policy challenges faced by Switzerland

Following the global financial crisis, there was a long phase of low inflation and expansionary monetary policy on an unprecedented scale in many countries. These international developments also affected Switzerland. As a small open economy, it is highly exposed to external disruptions. Switzerland's situation during this phase became especially difficult because of the strong upward pressure on the Swiss franc.

Two specific characteristics of Switzerland played an important role for this pronounced appreciation pressure. First, as a safe-haven currency, the Swiss franc tends to appreciate when global risk sentiment deteriorates. For example, the Swiss franc appreciated strongly during the Great Financial Crisis (GFC) and the European sovereign debt crisis. Second, the traditionally low level of interest rates in Switzerland meant that there was less leeway to the effective lower bound by international comparison. Interest rates in Switzerland are generally lower than abroad since the Swiss franc is valued as a safe investment given the country's long-standing political, fiscal and monetary stability. As the major central banks lowered interest rates significantly due to the GFC, the interest rate differential between Switzerland and these countries decreased, making the Swiss franc comparatively more attractive. This led to additional upward pressure on the Swiss franc.

The demand for safe assets and the strongly expansionary monetary policy in major currency areas resulted in the Swiss franc being significantly overvalued at times. As a consequence, falling import prices repeatedly pushed inflation into negative territory. The risk of deflation was acute. Furthermore, the at-times significantly overvalued Swiss franc posed major challenges for many Swiss companies, making it difficult for them to remain competitive.

Thus, for a small open economy like Switzerland, having a safe-haven currency can be a privilege, but it can also be a challenge. This challenge became apparent once more during heightened uncertainty worldwide following the outbreak of the Covid-19 pandemic and Russia's attack on Ukraine, when the Swiss franc again came under strong appreciation pressure.

The pandemic and the war in Ukraine fundamentally changed the global monetary policy context over time. After years of exceptionally low inflation, price levels suddenly surged in many countries. This inflationary pressure also impacted the SNB. But, as in previous years, inflation in Switzerland remained significantly lower

than in many other countries. Since mid-2023, inflation has been back in the range consistent with price stability.

Switzerland, as a small open economy with a safe-haven currency, has been subject to frequent and large shocks over the last decade. What lessons can we draw from these challenges in terms of maintaining price stability?

Lessons learned in terms of maintaining price stability

I would like to emphasise three points that are important in order to conduct effective and robust monetary policy despite adverse circumstances.

First, in dealing with deflationary risks in a global low interest rate environment, our experience shows that unconventional monetary policy instruments were necessary. To at least partially restore the traditional interest rate differential between Swiss interest rates and interest rates abroad, we lowered our policy rate well into negative territory for several years after the GFC. Moreover, we also bought foreign currency on a large scale at times. These foreign exchange interventions led to a marked expansion of our balance sheet. The use of foreign exchange interventions was necessary given that the strong appreciation of the Swiss franc was a direct source of deflationary pressure in Switzerland. The SNB's foreign exchange interventions have always been purely motivated by monetary policy considerations.

Although some episodes of negative inflation could not be prevented, the combination of a negative policy rate and foreign exchange interventions was effective in protecting the Swiss economy from the threat of persistent deflation during the years after the global financial crisis, including the outbreak of the pandemic. The SNB was able to ensure price stability and thus contributed to a comparatively robust development of the economy.

The SNB also used foreign exchange interventions in the phase of the sharp rise in global inflation, when price pressures were building in Switzerland too. Our first response to rising inflation was to allow the Swiss franc to appreciate by scaling back our foreign currency purchases. We then tightened monetary policy using both policy rate increases and foreign currency sales. Foreign currency sales were useful to ensure appropriate monetary conditions in a flexible manner and helped to dampen imported inflation quickly. With the forward-looking tightening of monetary policy, both via the exchange rate and the SNB policy rate, we were also able to limit second-round effects.

Both a negative policy rate and foreign exchange interventions will remain part of the SNB's monetary policy toolkit in the future. We implement our monetary policy by setting the SNB policy rate and, if necessary, using additional monetary policy measures to influence the exchange rate or the interest rate level. The SNB policy rate is the main instrument. It indicates the SNB's monetary policy stance and is thus the focus of our communication.

However, in addition to using appropriate measures, successful monetary policy also calls for foresight and flexibility when it comes to implementation. This brings me to my second point. For a small open economy like Switzerland, it is essential that the monetary policy framework allows for a certain flexibility in the policy response.

In its monetary policy strategy, the SNB equates price stability with a rise in the Swiss consumer price index between 0 and 2% per annum. Therefore, unlike many

other central banks, the SNB does not have a point target for inflation. Furthermore, in setting its monetary policy, the SNB focuses on the medium-term inflation outlook. This means that negative inflation or inflation rates in excess of 2% can also be temporarily permitted.

Our definition of price stability as a range and our medium-term focus enable us to respond flexibly to external shocks and to continually weigh up the costs and benefits of alternative monetary policy measures. Let me elaborate. During the period of low interest rates, we were able to accept levels of inflation close to the lower end of the range. In addition, our medium-term focus allowed us to tolerate short-term episodes of inflation below 0%. This was helpful, because a 2% point target for inflation in Switzerland would have required significantly stronger measures to ease monetary policy. From a cost-benefit perspective, this would not have been proportionate. On the other hand, our strategy allows us to take swift and early action if we see a risk of inflation leaving the price stability range for a protracted period. This was the case in the second half of 2021, and we therefore took quick and decisive measures to address the rising inflationary pressure.

Having a monetary policy framework that allows for a certain flexibility in the policy response does not contradict our clear mandate of ensuring price stability over the medium term. On one hand, our price stability range is comparatively low and forms an anchor for low inflation expectations. On the other hand, we have repeatedly proved that we are prepared to act decisively if price stability is threatened. With our flexible approach, and using the appropriate measures, we have been able to safeguard price stability well in very different environments.

And now to my third point. It is essential to preserve the independence of central banks. Besides an appropriate monetary policy framework, successful monetary policy over the long term also hinges on central banks' independence.

In recent years, some in politics and among the public have time and again looked to central banks with regard to issues that go beyond the core task of monetary policy, namely price stability. In our case, for example, we were confronted with various calls to use the asset side of our balance sheet to finance government tasks, to create a sovereign wealth fund or to increase our profit distribution to the Confederation and the cantons. Acceding to these demands would have fundamentally restricted our ability to use our balance sheet for monetary policy purposes. This would therefore have posed a significant threat to achieving price stability.

Price stability can only be achieved with an independent monetary policy. This independence can only survive if the mandate continues to be narrow. The broader the mandate becomes, the more difficult it is to explain to the public why a central bank should be independent. Central banks do not have the instruments needed to bring about lasting change beyond the positive impact of a stability-oriented monetary policy. It is essential to focus and deliver on our primary mandate in order to retain the public's trust.

Concluding remarks

Let me sum up with a few concluding points. In the last decade, the strong focus on our mandate and our monetary policy strategy have proven their worth in a wide variety of situations. But they alone are no guarantee of a successful monetary policy.

We must always critically examine our own assessments, identify changes in conditions as early as possible and analyse their impact. It is also particularly valuable to exchange views and share experiences with other central banks. Therefore, I am especially grateful to the BIS for making many highly relevant discussions possible.

Thank you for your attention.

Remarks by Sethaput Suthiwartnarueput

Sethaput Suthiwartnarueput, Governor, Bank of Thailand

The last decade has tested our monetary policy frameworks through the extremes of both stubbornly low inflation and unanticipated high inflation. All this has been against the backdrop of rapid financial, economic and geopolitical changes that manifestly complicate the calibration of appropriate policy. Reflecting on this experience, I would like to highlight **one lesson and one conundrum.**

First, the lesson. With so much uncertainty encountered over the past decade, I cannot understate **the importance of a robust monetary policy framework.** This consists of at least three key elements.

The first essential element is to **put a premium on stability.** In the face of noisy economic signals, policy *itself* should not be an additional source of uncertainty. This can be achieved by erring on the side of stability and **not overreacting to the latest data**. Data can be noisy; thus policy should aim to be "outlook-dependent" as opposed to "data-dependent". In essence, this is the signal extraction problem for policy. For example, given that inflation comprises a myriad of relative price changes, the challenge is how to look through transitory price changes and focus on the persistent underlying price trend. A related point is to **avoid excessive fine-tuning**. Events of the past decade have highlighted the need for us to remain humble and to not overestimate our ability to influence or affect key variables. During the recent high-inflation episode, we have seen that inflation is subject to very large relative price changes that are completely outside of our control.

The second element is to **preserve optionality.** Given the amount of uncertainty we face, it is important to avoid being caught out and forced to reverse course. In setting policy, rather than aiming for what is optimal, it may be better to aim for a policy setting that is robust to a wide range of outcomes. This means not tying yourself down or doing things that unnecessarily constrain your room to manoeuvre, such as through excessive forward guidance – at least the kind that suggests some sort of predetermined policy path. Finally, having multiple buffers such as well capitalized banks, foreign exchange (FX) reserves and policy space is also key to preserving optionality and enhancing the robustness of the monetary policy framework.

A third key element is to **utilize complementary policy tools**. Using a macro-financial stability or integrated policy framework has helped improve policy trade-offs and afforded monetary policy more degrees of freedom. For many small open economies, including Thailand, judicious use of FX intervention has been quite important in smoothing out excessive volatility. At the same time, macroprudential tools can help constrain excessive build-up of financial imbalances, while financial measures more broadly can help cushion fragile groups. That said, while we have a good toolkit for monetary policy, such as Taylor rules and r-stars (the real natural rate of interest), the analytical toolkit to support complementary policy tools like FX intervention or even macro-prudential measures is lacking. Right now, we do not have the equivalent of a "credit-to-GDP star" to guide policy decisions. This highlights the need for a better analytical toolkit to guide us in operationalizing the macro-financial stability framework.

Now let me turn to the conundrum. If we take a step back and look over the past few decades, there is little doubt that monetary policy overall, and inflation targeting in particular, has been a clear success. By any metric, be it reduced output volatility, lower levels of average inflation or a reduced number of episodes of banking and financial stresses, **monetary policy has delivered**. For emerging market economies in particular, credible policy frameworks – most importantly central bank independence (CBI) – have been *the* key reason for the remarkable resilience that they have shown over the last few years in the face of surging world interest rates.

Yet, currently, central banks seem to be under pressure more than at any time over the last decade. Central bank independence in many countries, including Thailand, is being challenged despite having done a reasonable job over past decades. As such, **it seems that while delivering on our mandates is a necessary condition for maintaining independence, it is not a sufficient one**. Why is this the case? While I do not have a clear answer, allow me to offer three thoughts.

First, there seems to be **a disconnect between central banks' key performance indicators (KPIs) and the public's KPIs.** Monetary policy focuses on broad aggregates or average figures that may not necessarily resonate with the public because these figures mask heterogeneity across sectors, firms and households. Therefore, while broad aggregates may appear fine as a whole, they may not be that way for a lot of people. It is a case of *my* GDP vs *your* GDP, *my* shopping basket vs *your* shopping basket. Also, our **policy horizon is a medium-term one**, whereas firms and households may focus more on the short term, as they live in real time. Importantly, the disconnect can also arise because **much of what we do is to prevent bad things from happening.** Successful policy prevents much worse outcomes such as runaway inflation or a banking crisis. But in doing so successfully, the public never experiences that gain but only the pain. They taste only the bitter medicine and not the disease. It is hard to motivate policy in a compelling way by referring to a counterfactual.

All this is *inherent* in the nature of our policy and is thus nothing new. The question then is why has the discontent become more intense lately? This brings me to the second factor. Over the last decade **there has undoubtedly been dramatic changes in the nature and method of public discourse.** Over time, information flow and public debate has moved from a largely centralized model – through traditional mass media (television, radio, newspapers) – to increasingly decentralized ones (social media, online platforms). With greater fragmentation and competition for attention, alternative narratives and polarisation arise more easily through virtual echo chambers. It has become more challenging to get the message through.

Finally, over the last decade central banks have been through a lot. Unconventional policies, expanding balance sheets and pervasive crisis measures **have expanded central banks' footprints in private markets.** This raises peoples' expectations on what a central bank can achieve, and it results in not just moving the goalpost but also adding more goalposts. As expectations increase, it becomes harder to ring-fence our reputation, credibility and the case for central bank independence.

Whatever the reason for the divergence in performance and perceptions, we need to understand and address it because if we allow CBI to be eroded, then we will not be able to deliver on our core mandates. Here let me note that even as the focus

of CBI is mostly in regard to monetary policy, the fact is that **CBI hinges just as much on how central banks perform in other areas,** notably banking supervision. Much of the underlying source of pressure on central banks arises from perceived shortcomings in the banking sector – be they high fees, financial access, excess profits or bank failures. Therefore, for my closing point, let me leave us with some food for thought for the future – **doing monetary policy well requires doing central banking well**.

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