Monetary policy in the 21st century: lessons learned and challenges ahead

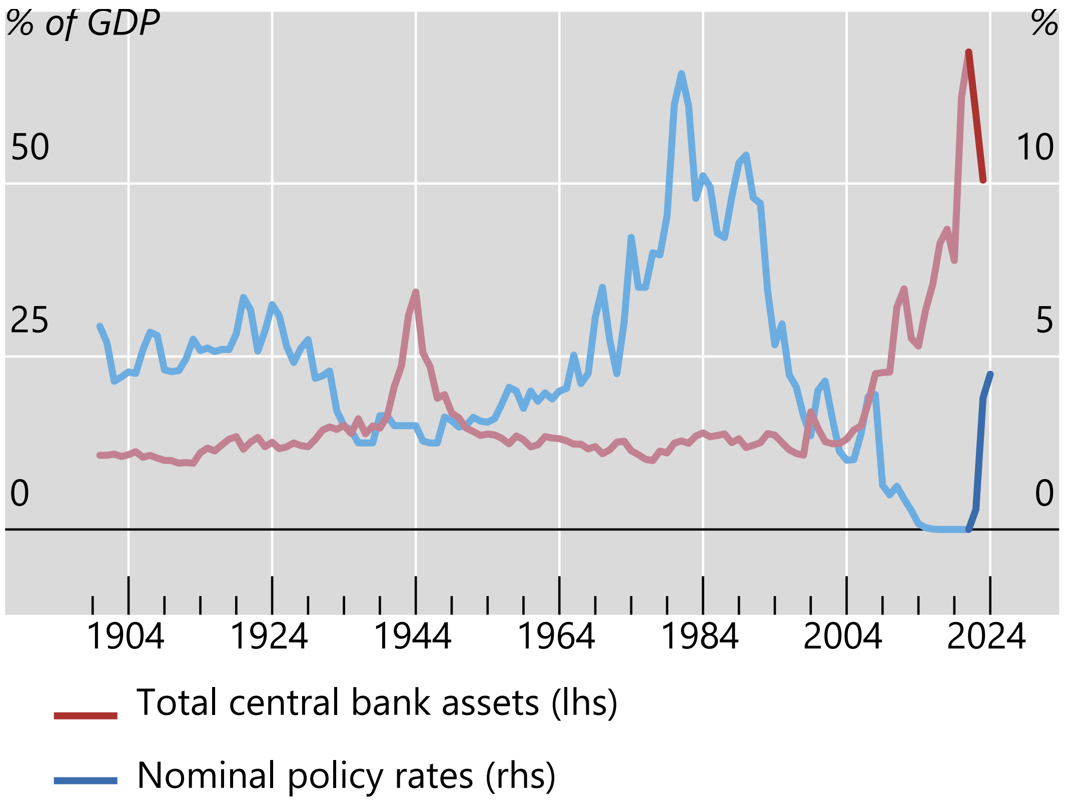
Claudio Borio

Head of the Monetary and Economic Department

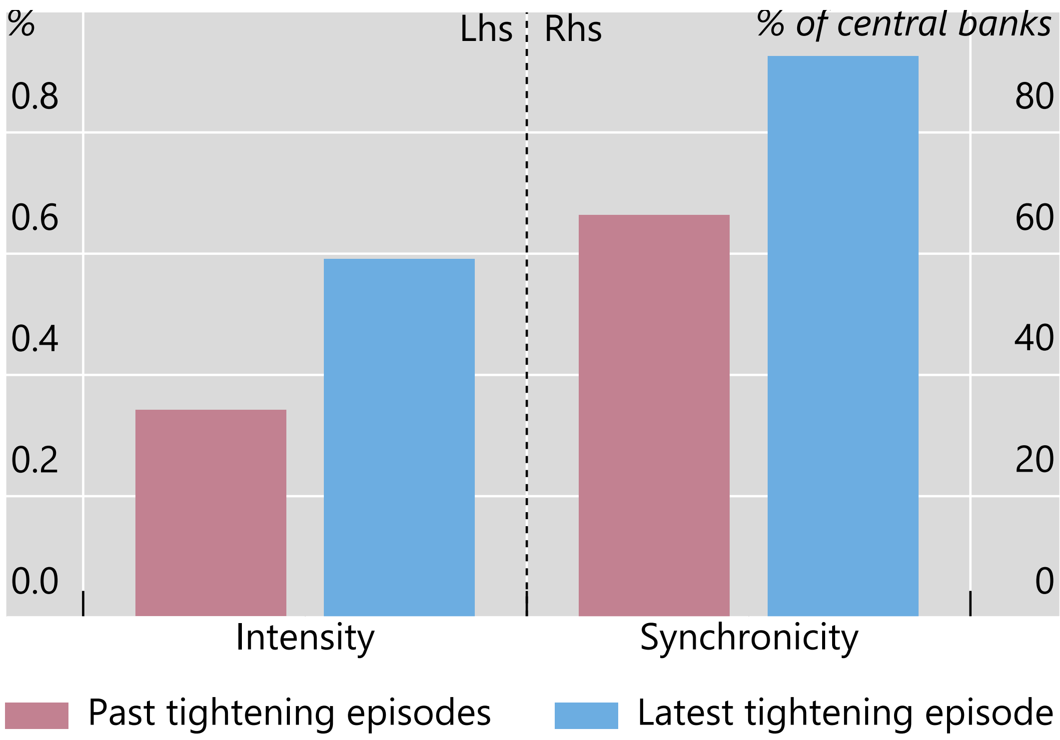
Basel, Switzerland, 30 June 2024

A tumultuous 21st century

Policy rates to new troughs and balance sheets to new peaks



An intense and synchronised tightening



Key takeaways

Five lessons

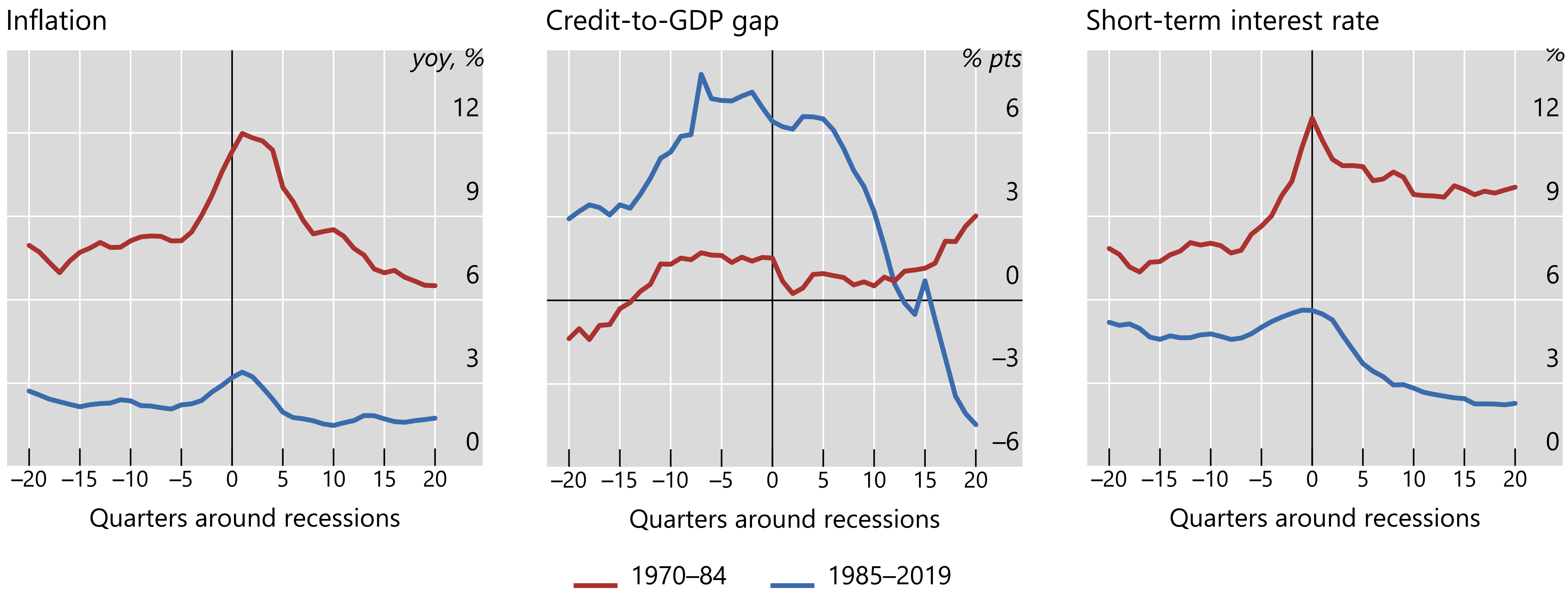
1. Ability to prevent transitions to high-inflation regimes
2. Ability to stabilise the financial system during crises
3. Impact of prolonged and intense easing
4. Communication
5. Role of complementary tools

Five considerations to guide refinements

1. Robustness
2. Realism in ambition
3. Safety margins
4. Nimbleness
5. Coherence across policy domains

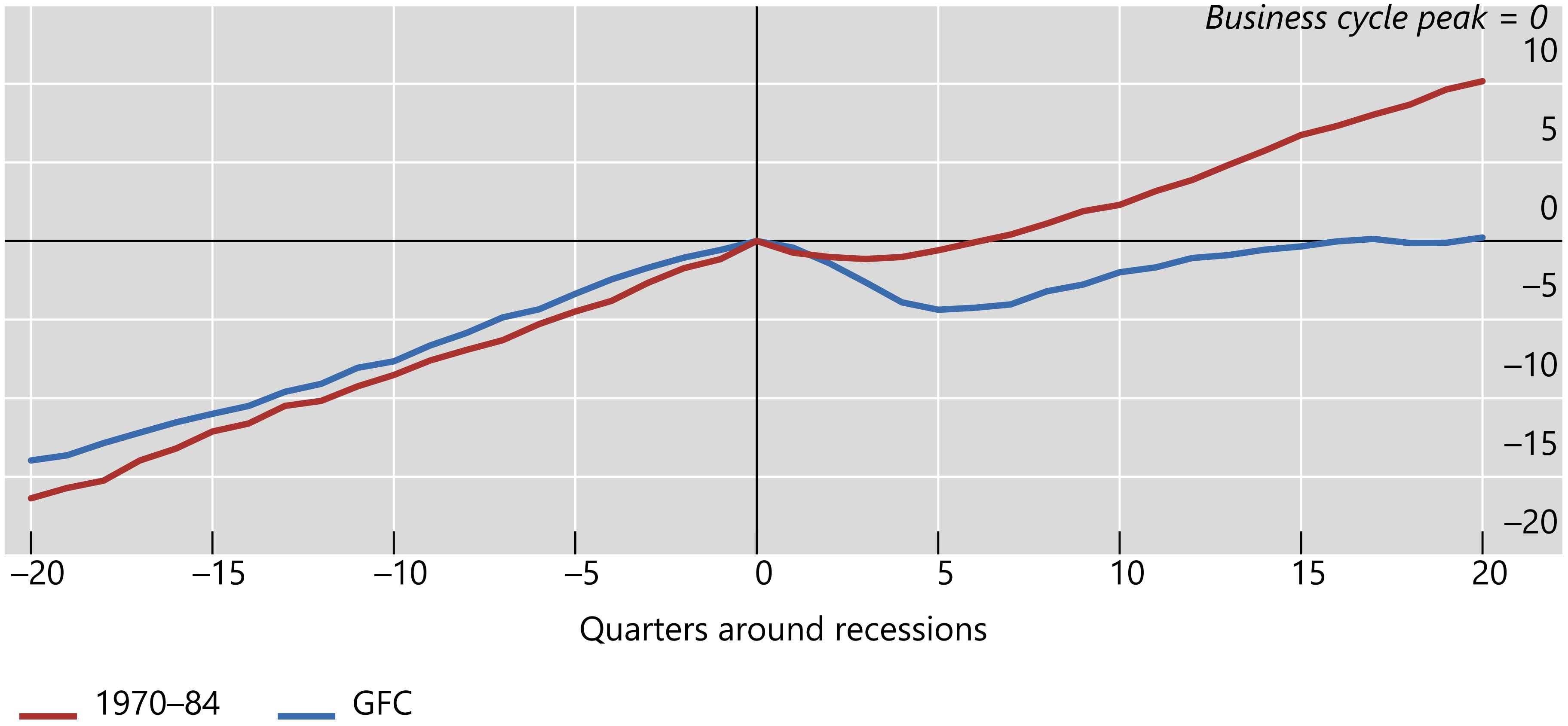
The tumultuous journey

The changing business cycle: from inflation-induced to financial recessions



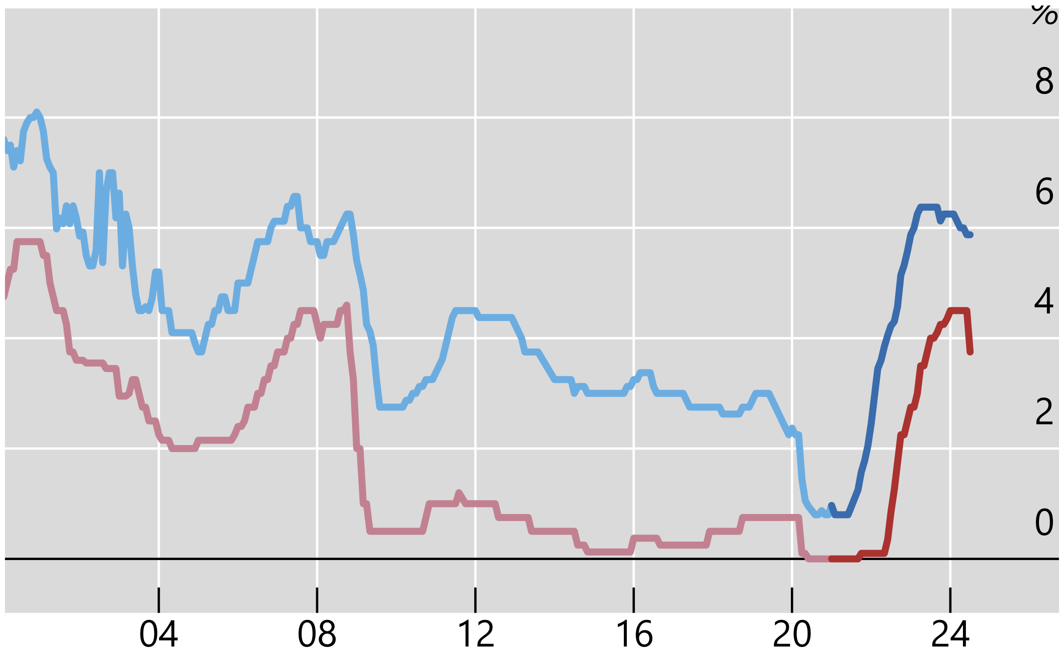
The GFC financial recession was especially deep and prolonged

GDP around the GFC and pre-1985 recessions

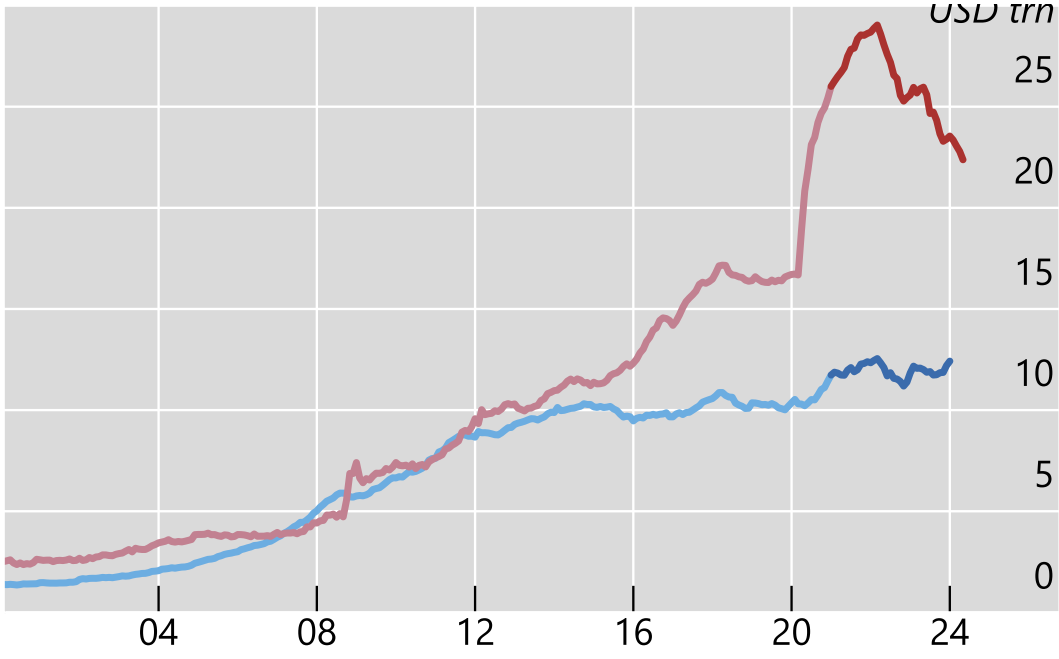


A tumultuous journey: from the GFC to COVID-19 and the inflation surge

Nominal policy rates

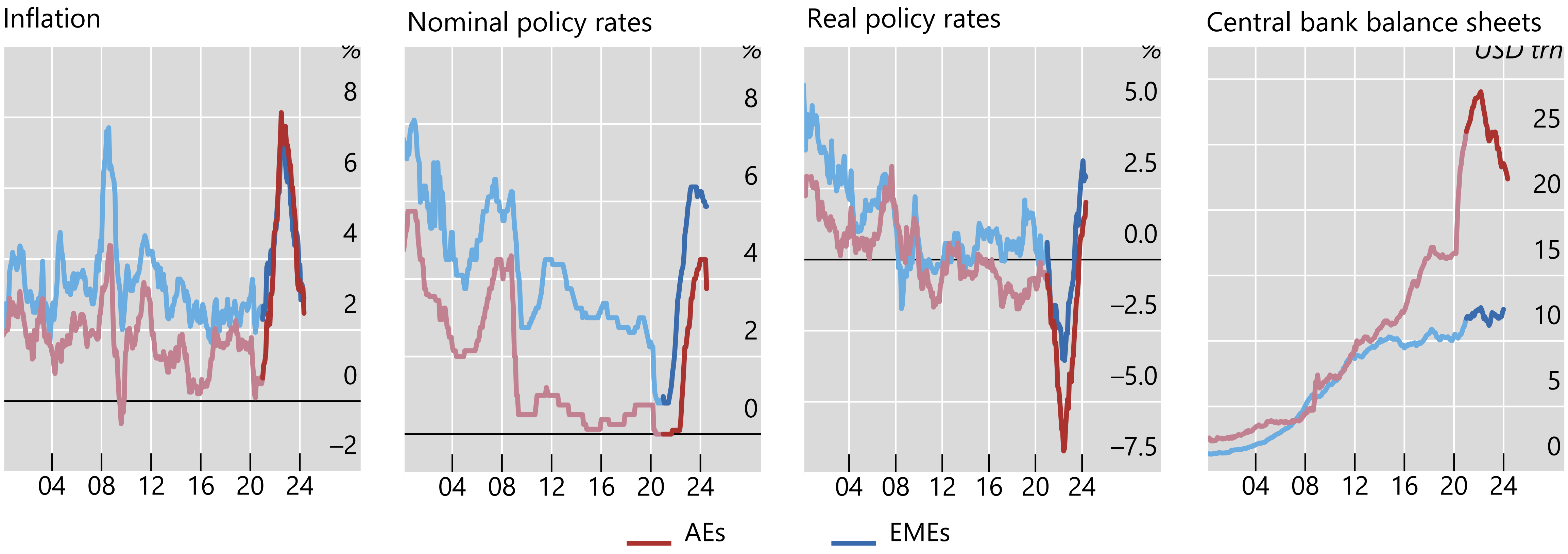


Central bank balance sheets



AEs EMEs

Where are we now?



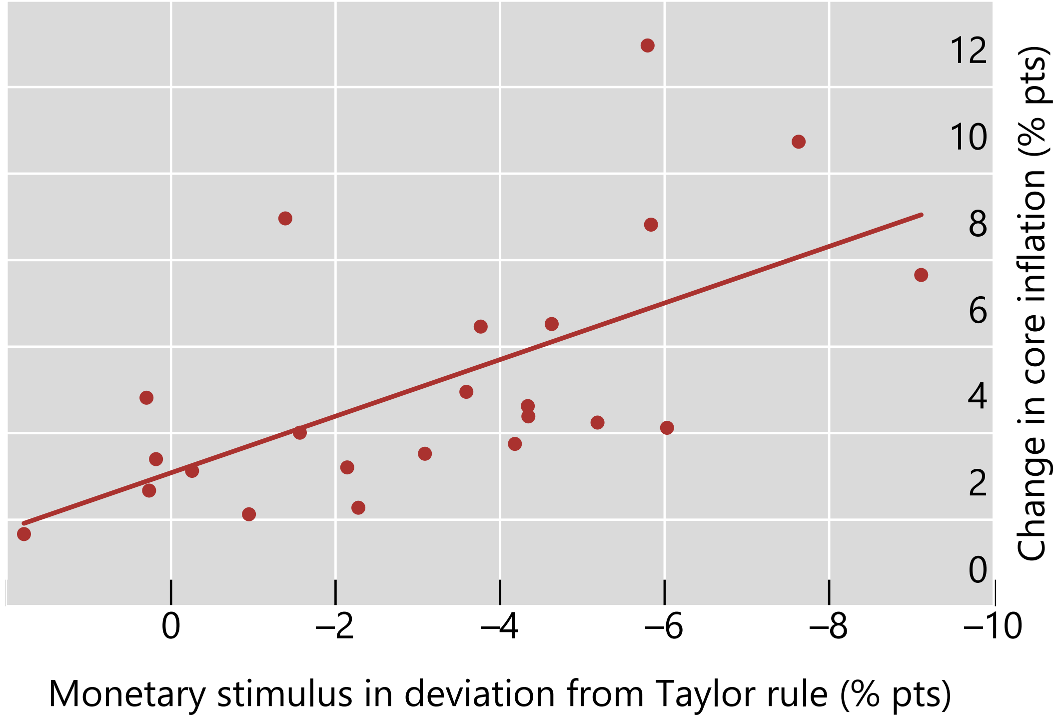
Lessons learned

Lesson 1

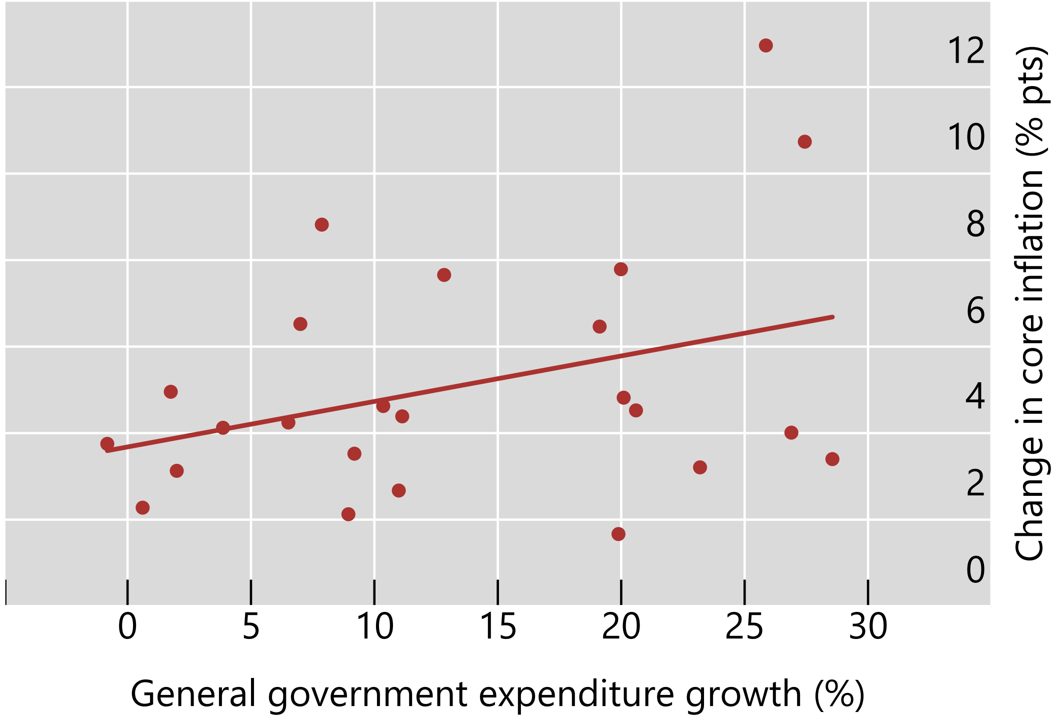
Forceful monetary policy tightening can forestall a shift to a high-inflation regime

An expansionary policy mix contributed to the inflation surge

Monetary policy

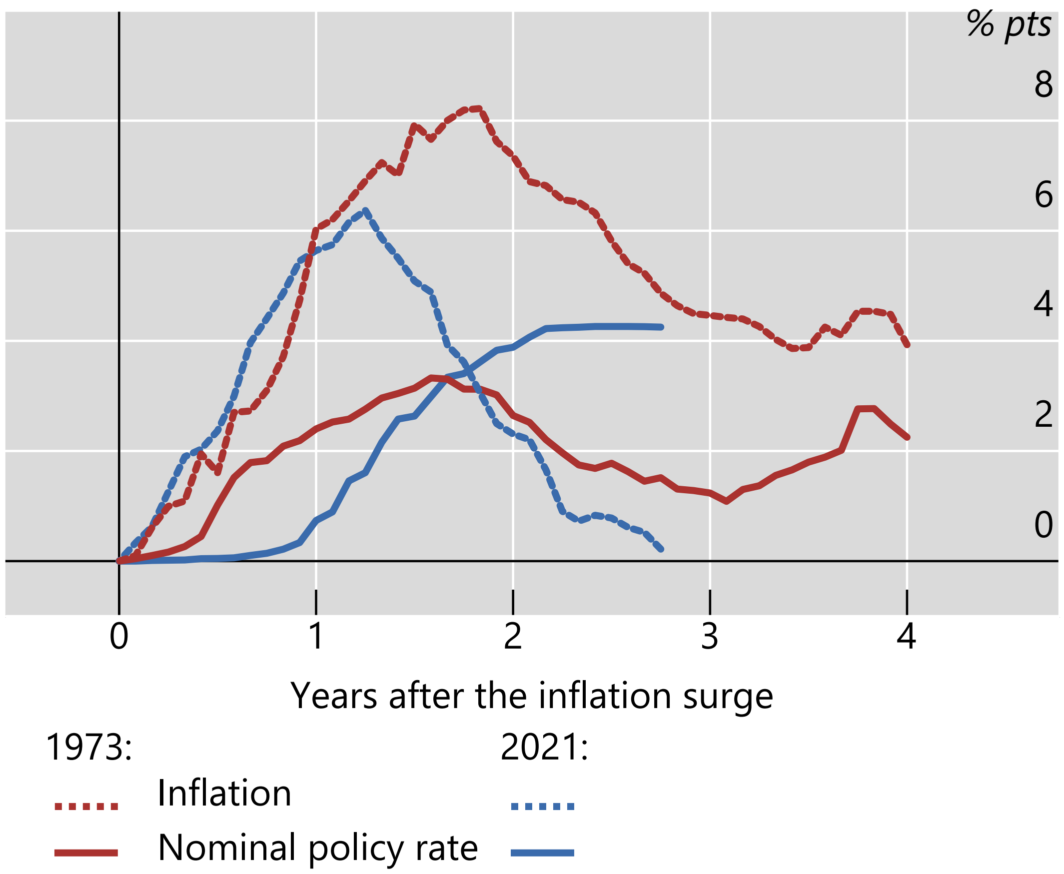


Fiscal policy

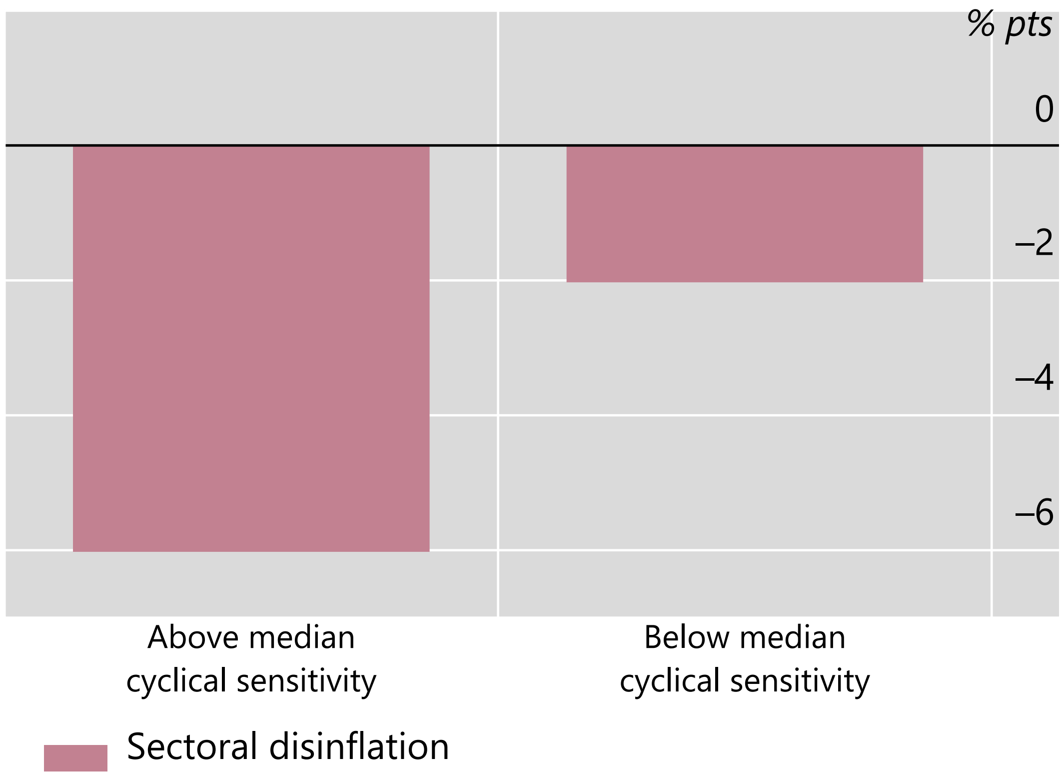


Forceful monetary tightening can prevent the transition to a high-inflation regime

Today vs 1970



Sectoral price responses



Lesson 2

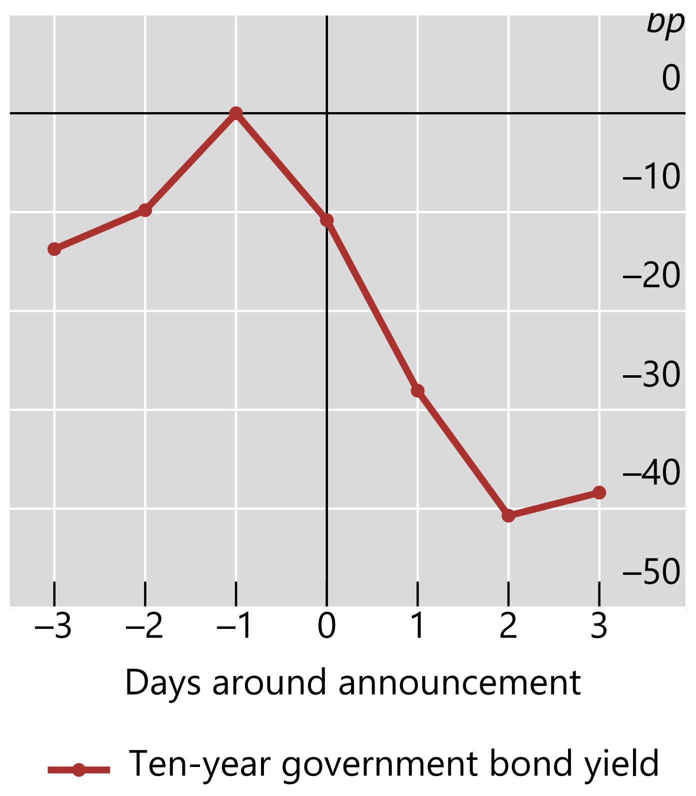
Forceful action can stabilise the system at times of financial stress and prevent the economy from falling into a tailspin

Forceful central bank action can stabilise the system at times of financial stress

Swap markets

Corporate bond markets

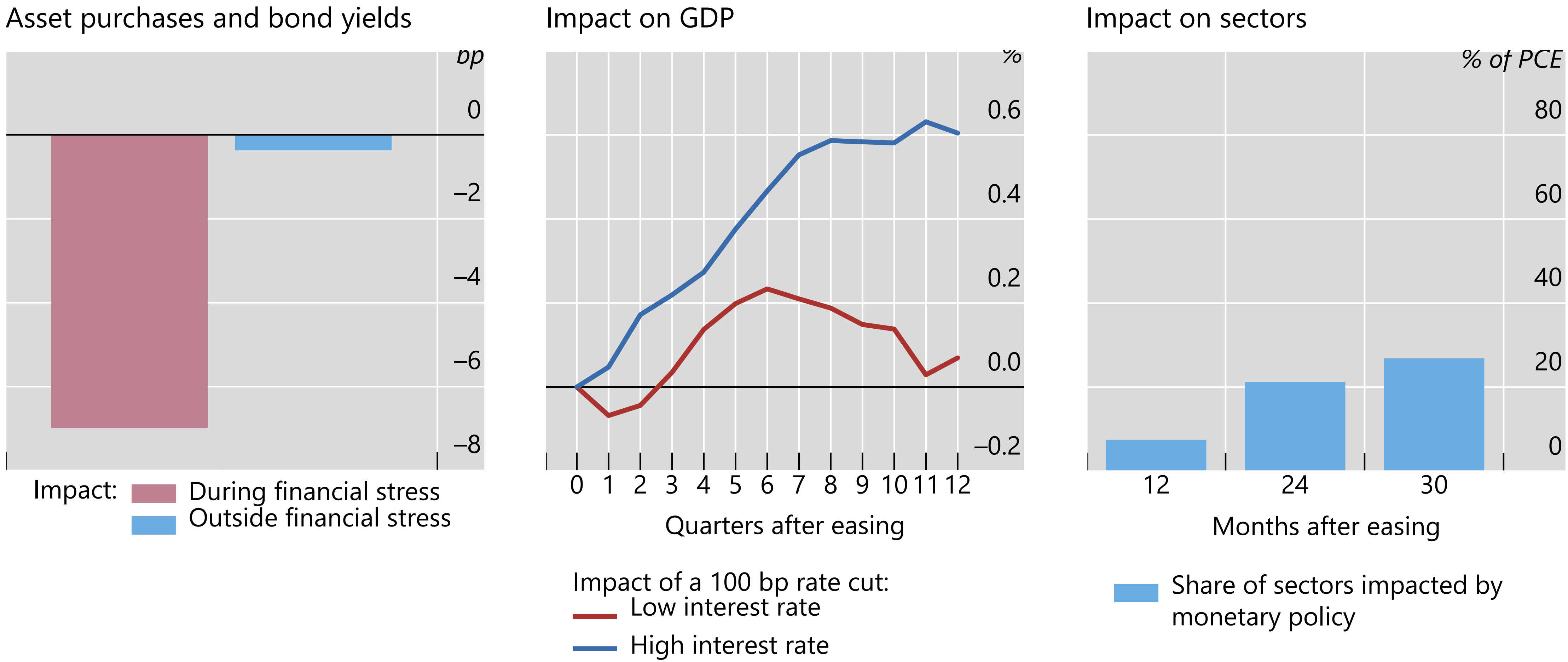
EME sovereign bond markets



Lesson 3

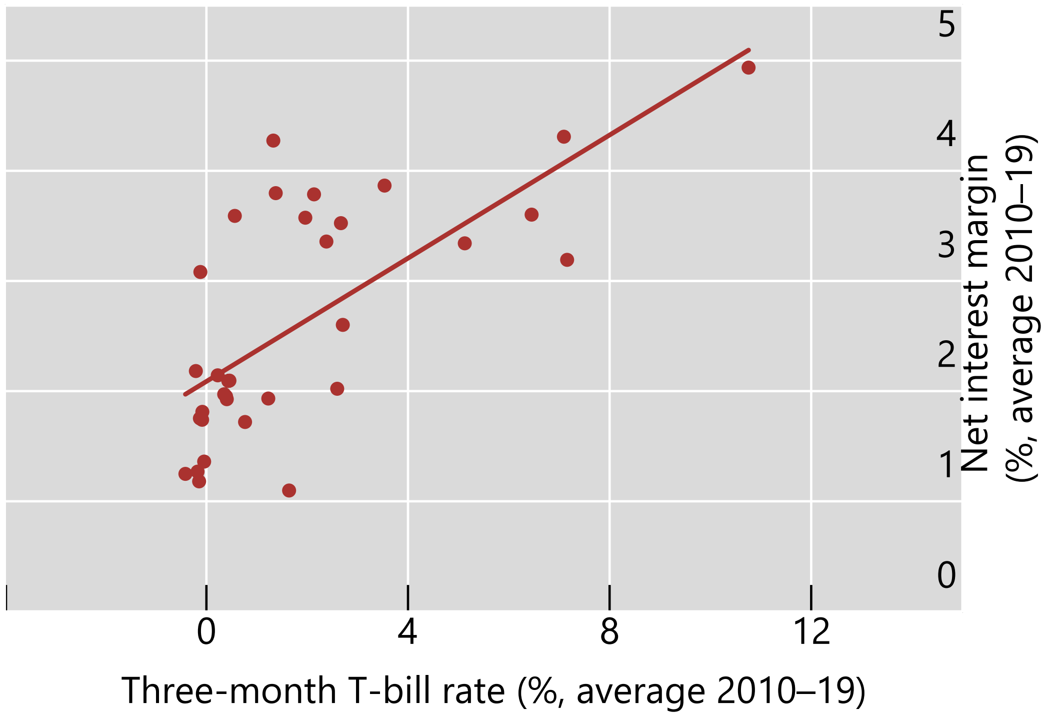
Strong and prolonged monetary easing faces limitations

Prolonged monetary easing has limitations…

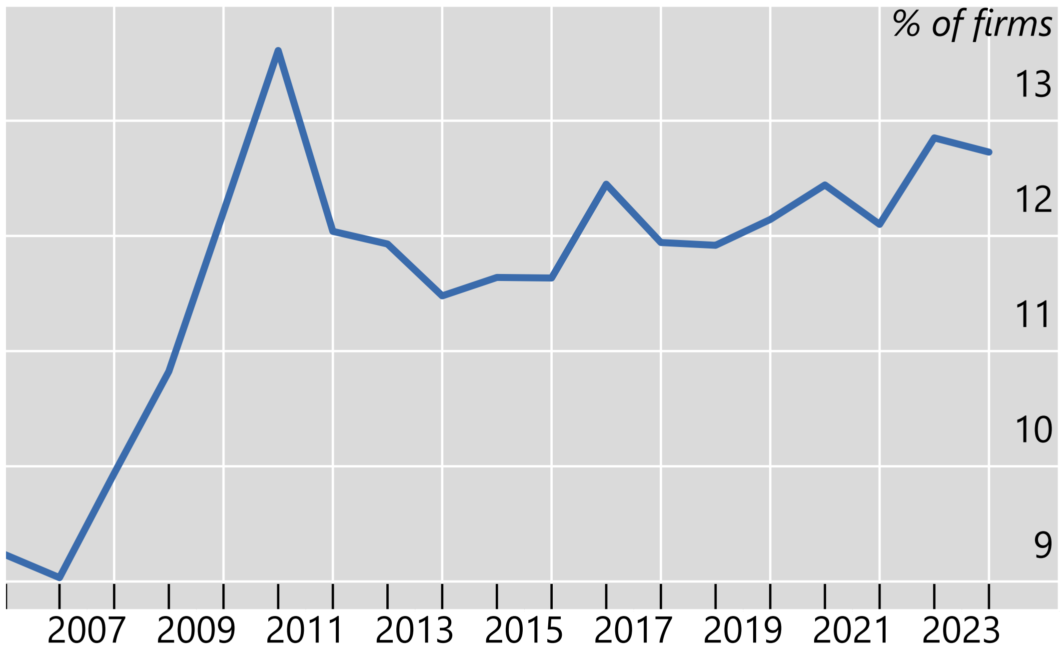


Prolonged monetary easing has limitations and entails side effects

Lower bank net interest margins…



Proliferation of zombie firms

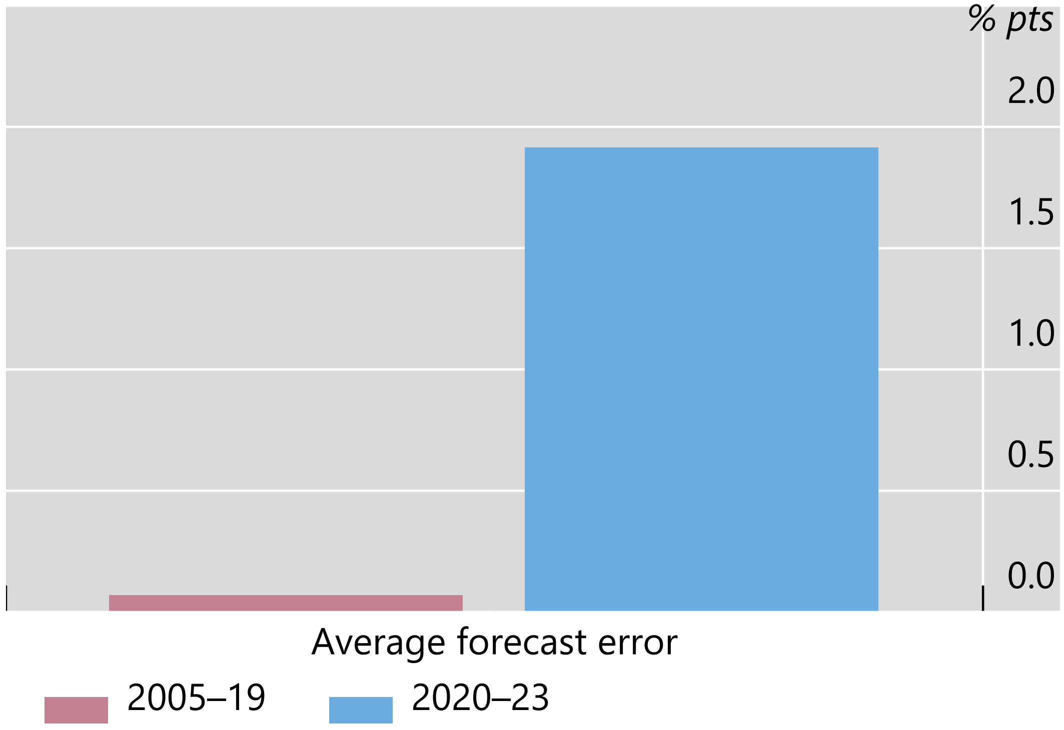


Lesson 4

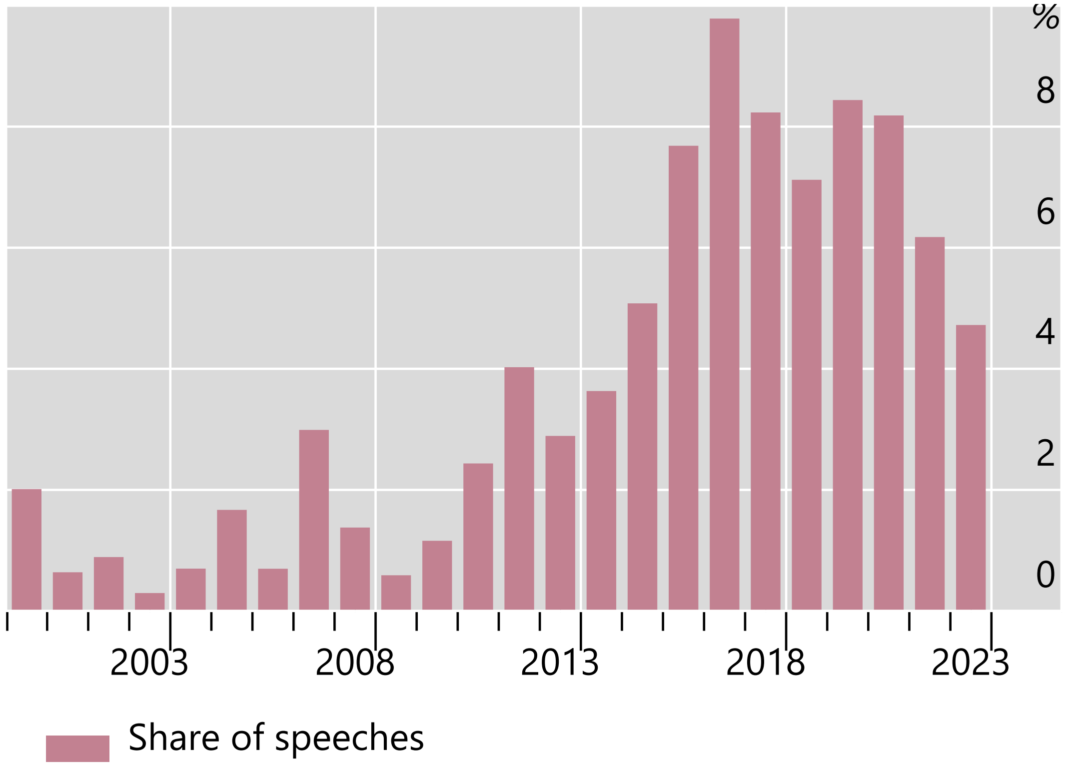
Communication has become more complicated

Communication has become more complicated

Failure to anticipate inflation surge



Speeches mentioning “inequality”

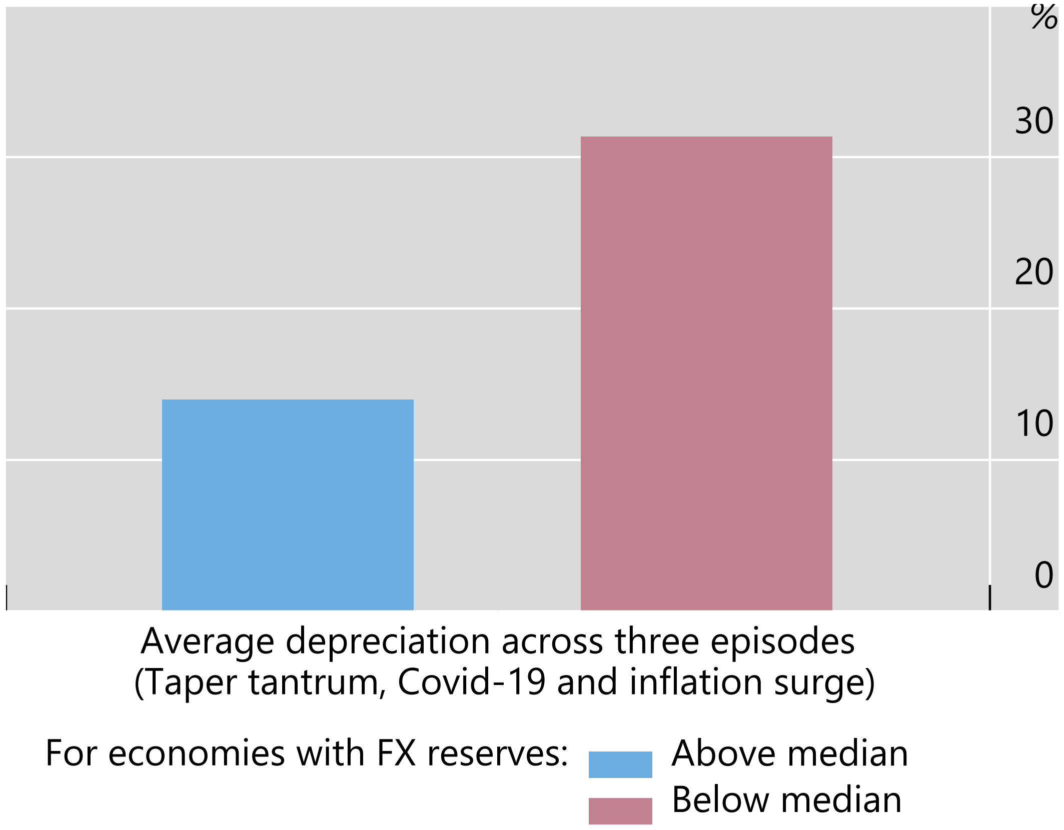


Lesson 5

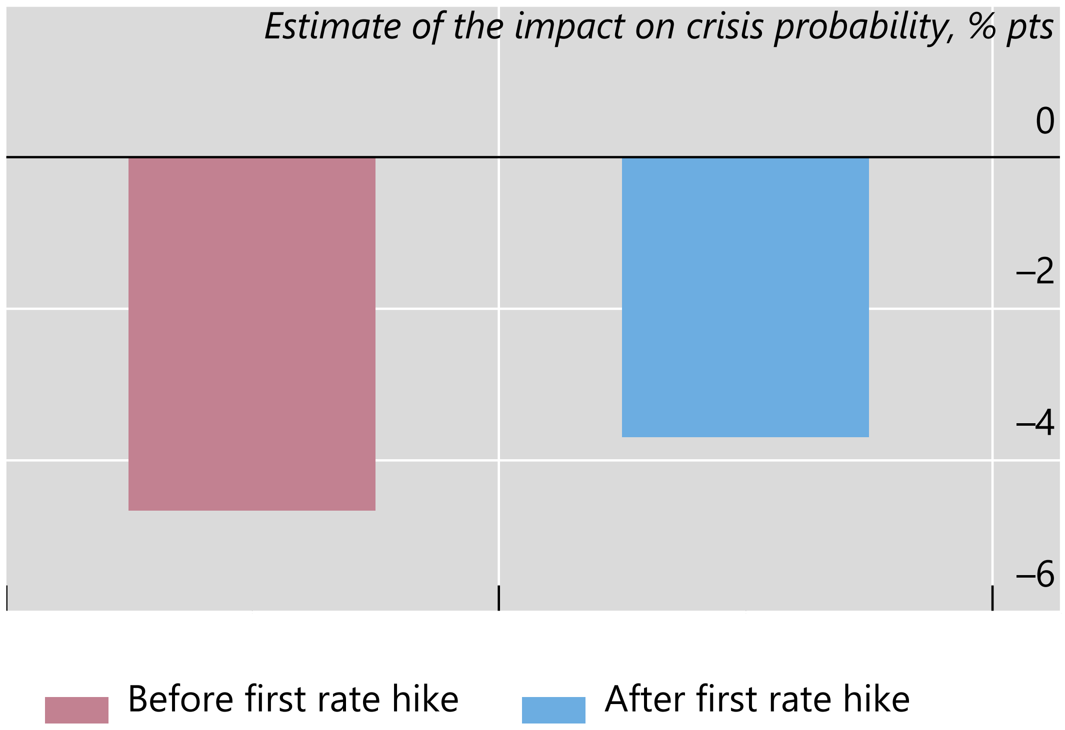
Central banks can deploy complementary tools to improve the trade-offs monetary policy faces between price and financial stability

FX intervention and macroprudential measures can enhance resilience

FX reserves limit depreciation during crises



Macroprudential tightening reduces financial stress



Refinements to monetary policy frameworks

Challenges ahead

Fiscal trajectories

Inelastic and shock-prone supply

Or return to disinflationary pressures?

Five considerations to guide refinements

1. Robustness
2. Realism in ambition
3. Safety margins
4. Nimbleness
5. Coherence across policy domains

Avoid "growth illusion"

Focus on price and financial stability

Implications of guiding considerations

Operational definition of price stability

Acceptable deviations from targets

Deployment of tools

Communication strategies and institutional arrangements

Operational definition of price stability: hardwire a low-inflation regime

Low enough not to influence behaviour

No upward adjustment to current targets

Acceptable deviations from targets consistent with inflation regimes

Greater tolerance for inflation shortfalls from narrowly defined targets

Strong reaction to inflation surges

Prudent deployment of tools

Room for manoeuvre as explicit consideration

Premium on exit strategies

Balance sheets as small and riskless as possible

Limit reliance on forward guidance and unobservable model-specific concepts

Communication strategies and institutional arrangements to prevent short-termism

Narrow the expectations gap

Safeguard central bank independence

Coherence across policy domains to ease monetary policy trade-offs