

Unconventional Monetary Policy and Central Bank Independence

International Conference *Central Bank Independence: Progress and Challenges*

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Manuel Sánchez

Good morning and welcome to our first session of the day, devoted to the discussion of unconventional monetary policy and central bank independence. Yesterday's presentations were extremely insightful, and I am certain that in this second and final day of our conference we will extend and deepen our understanding of the implications of central bank independence.

During the last three decades, the world has witnessed a generalized reduction of inflation. This progress, which occurred in most advanced and developing nations, reflected the commitment of central banks to attaining price stability, after a change in the paradigm explaining the causes of inflation.

To a large extent, the pledge to price stability was credible thanks to greater independence granted to central banks, both de jure and often de facto, and particularly from fiscal authorities, during those years. Lower inflation strengthened the legitimacy of monetary policies, including, prominently, those implemented under the inflation-targeting approach.

Independence and the success at anchoring inflation expectations allowed central banks to respond promptly and aggressively to the big financial crisis and its

aftermath. Being the epicenters of turmoil, the United States and other advanced countries applied this flexibility pervasively.

An essential element of central banks' new strategies was the implementation of unconventional policies, in the form of large-scale purchases of government and private-sector assets, and extensions of long-term liquidity facilities to financial institutions, among other measures.

These policies have been effective at helping to normalize the functioning of financial markets in critical times and have likely supported the economic recovery of advanced countries. Yet, they have also generated some unintended consequences, such as market distortions, the postponement of needed debt adjustments, and some negative international spillover effects.

Unconventional monetary policies have also posed significant challenges, some of which may have some bearing on the independence of central banks. By way of illustration, nontraditional measures have translated into unprecedentedly loose monetary stances. If eventual unwinding is not done properly, inflation control could be put at risk, thereby damaging the cornerstone of the trust that legitimized monetary independence in recent years.

Additionally, unconventional measures may have increased people's expectations of the capacity of monetary policy to achieve many objectives different from price stability, which are not otherwise being addressed by appropriate policies.

Pressures to overload monetary policy with many goals, even if the tasks are claimed to be temporary, may lead to disappointment and loss of credibility for central banks.

Finally, in the presence of high and unsustainable public-debt paths, monetary policy may face the danger of fiscal dominance, anathema to the assumption of independence. In fact, some unconventional monetary policies already implemented could be interpreted to be of a quasi-fiscal nature, involving credit allocation decisions, and, hence, they could raise skepticism concerning the degree of independence of the central bank or complaints of favoritism granted to certain sectors.

These and other challenges clearly require prudence in the way monetary policy is conducted, and good-quality communication in the face of likely increasing public demands for transparency and accountability. Failure to respond appropriately may compromise the credibility of monetary policy, reducing its effectiveness in preserving price stability, and may even bring calls for legally curtailing central bank independence.

To address these and other issues related to unconventional monetary policy and central bank independence, we are honored to have four outstanding panelists. With the benefit of their wide-ranging perspectives and insight, I am certain this will be a highly interesting and lively session.