



BANK OF ENGLAND

Central Bank Independence – What We Know and What We Don't

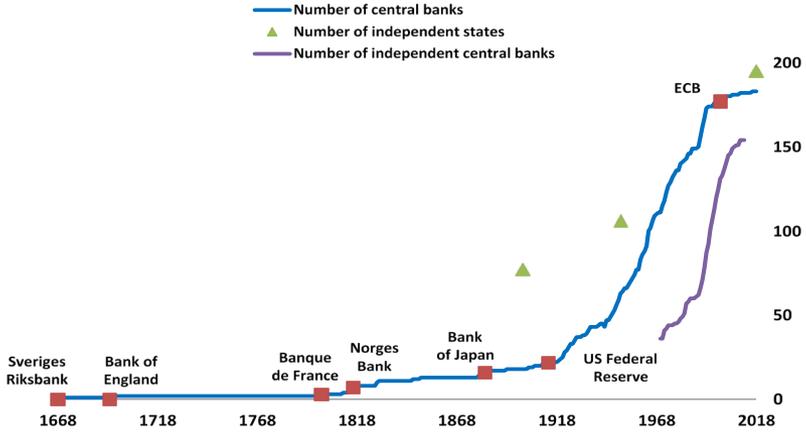
Andrew G Haldane

Norges Bank Nicolai Rygg 2021 Virtual Panel Debate

8 April 2021

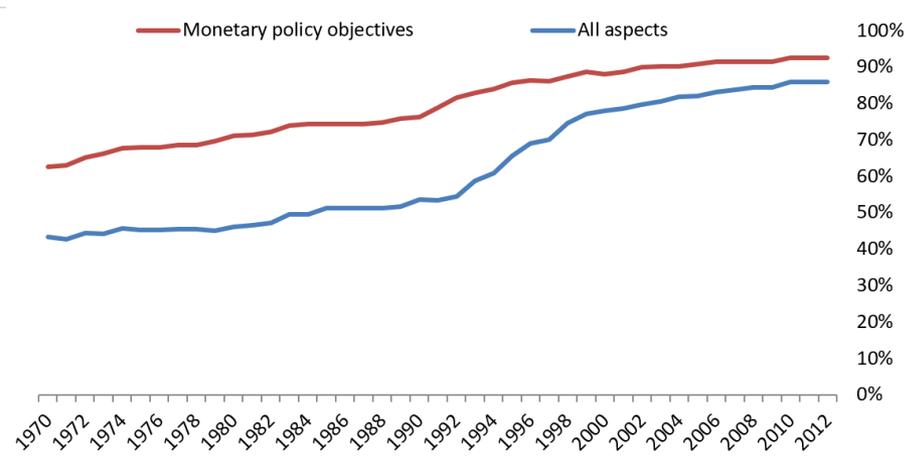
The Era of Central Banking

Chart 1: Number of central banks



Source: Central Banking Directory

Chart 2: Percentage of independent central banks



Source: Garriga (2016) using index of Cukierman et al (1992).



The Great Inflation of the 1970s

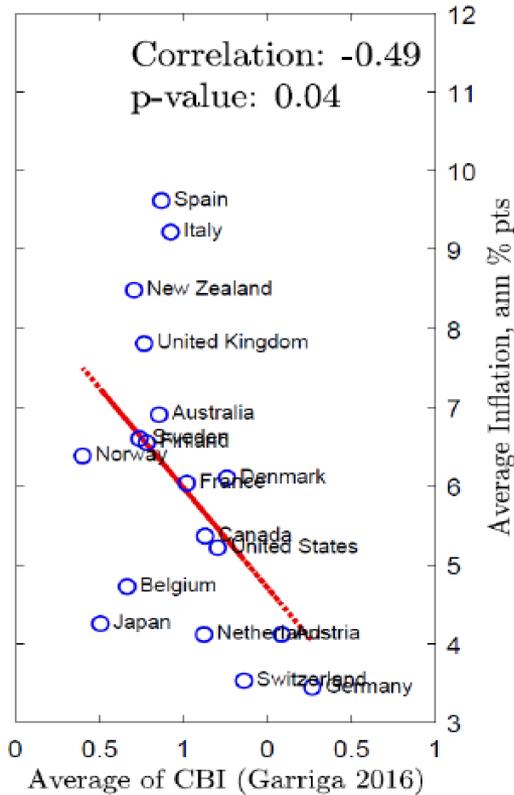
- Loss of nominal anchor (demise of Bretton Woods)
- Oil shocks
- Belief in exploitable long-run trade-off
- Time-inconsistent policies (Kydland/Prescott)
- Inflation bias (Barro/Gordon)
 - Great Inflation of the 1970s/80s



The Case for Independence – the Free Lunch?

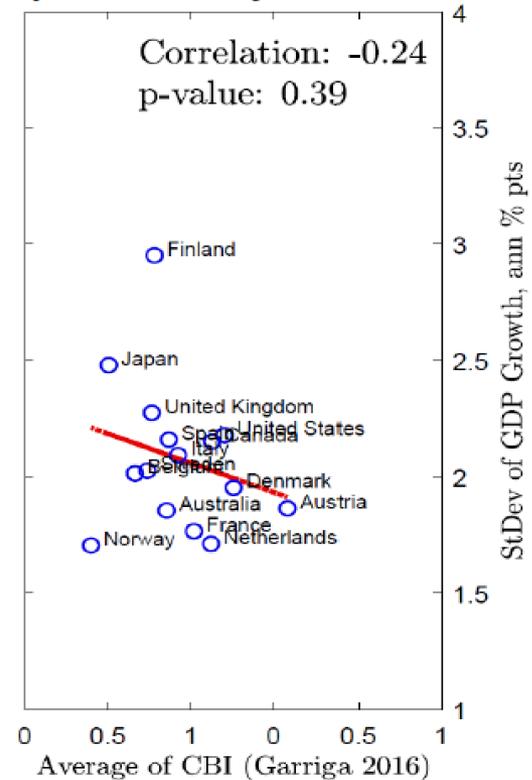
1970-1999

Chart 4: Independence and Inflation



Source: Bank of England

Chart 6: Independence and Output variability



Source: Bank of England

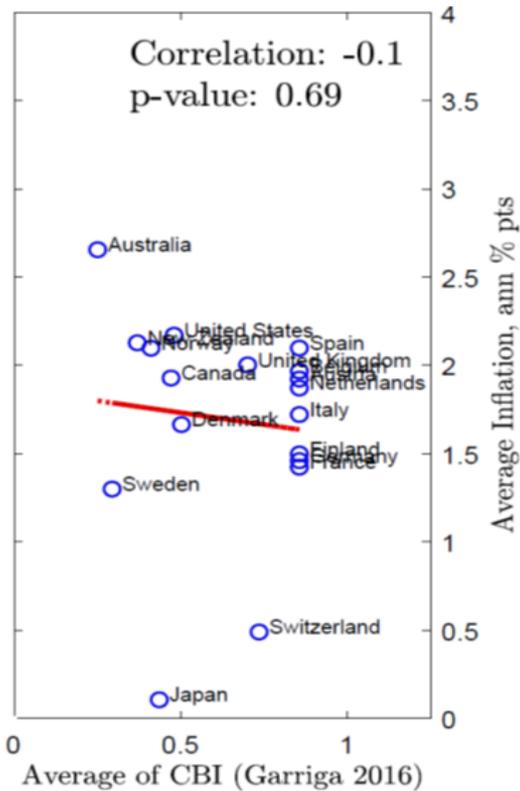


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The Case Disappears?

2000-2018

Chart 8: Independence and Inflation

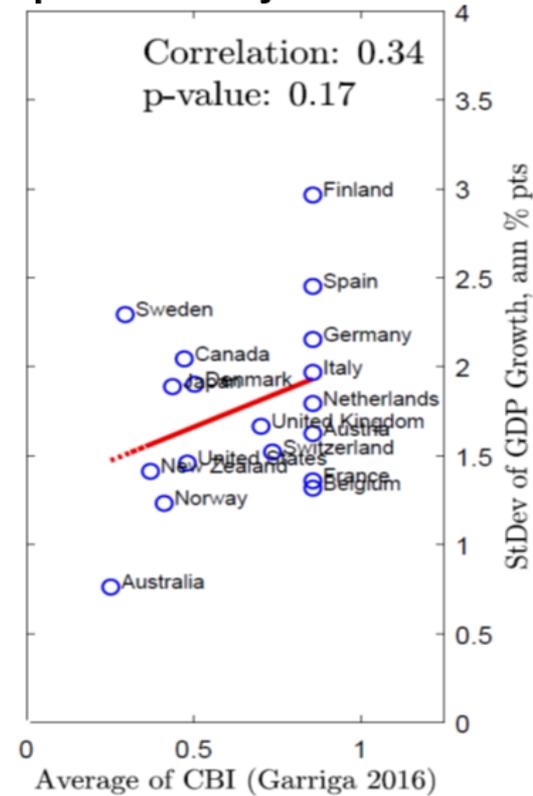


Source: Bank of England

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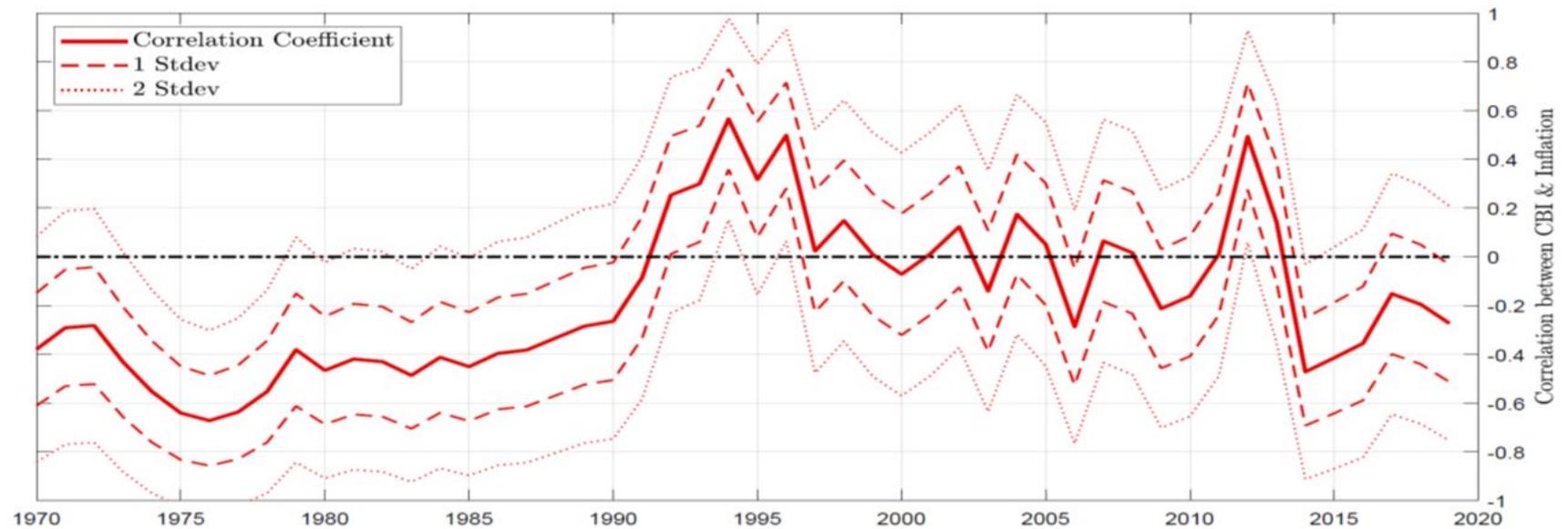
Chart 10: Independence and Output variability



Source: Bank of England

The Case Disappears?

Chart 11: Correlation between Independence and Inflation through time



Source: Bank of England.



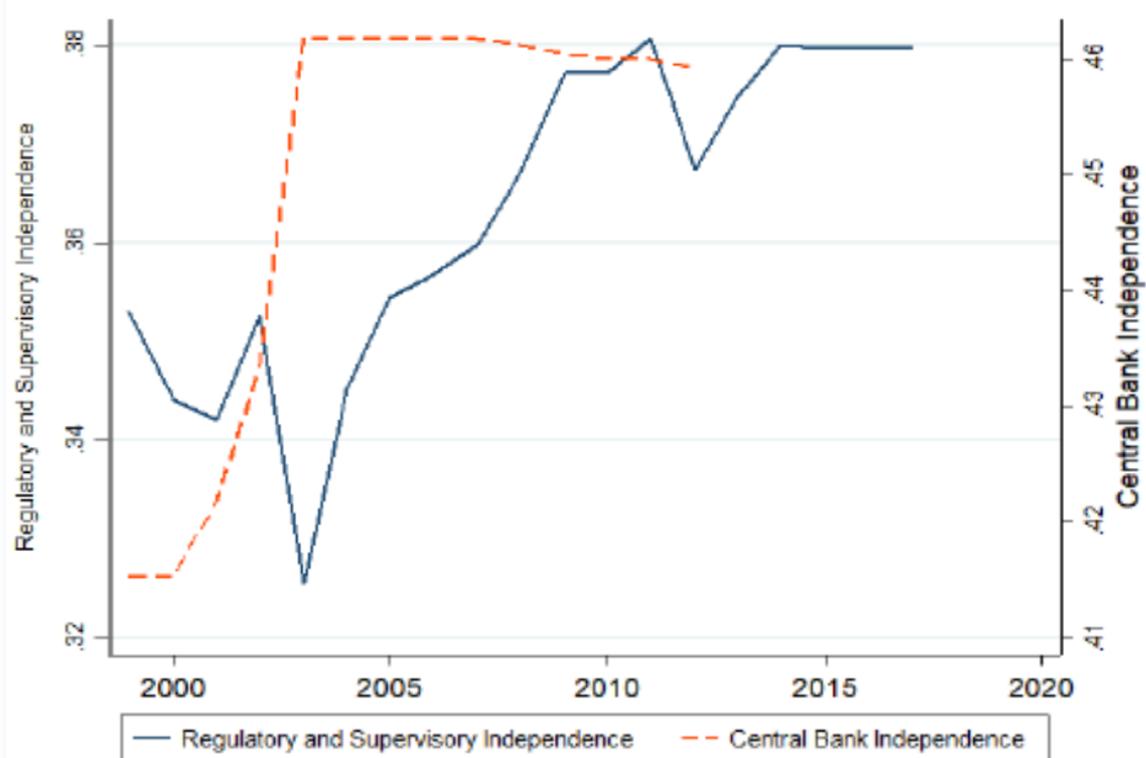
Independence and Financial Stability

- Financial stability also suffers a time-consistency/crisis bias problem
- Less focussed on, academically and practically, until recently
- This problem may be even more acute
 - Longer duration credit cycles (“this time is different”)
 - Higher costs of crises
- Shift towards independence of regulatory/supervisory decision-making since the global financial crisis



Rising Tide of Independence

Chart 14: Central Bank Independence and RSI



Source: Fraccharoli et al (2020)



Independence and Financial Stability – Another Free Lunch?

Table 2: RSI and Financial Stability

	Measures of financial stability	
	Non-performing loans	ROA volatility
RSI Reforms	-2.8***	-1.9***
<i>[coefficient range based on robustness checks]</i>	<i>[-1.7 to -2.9]</i>	<i>[-0.8 to -1.9]</i>

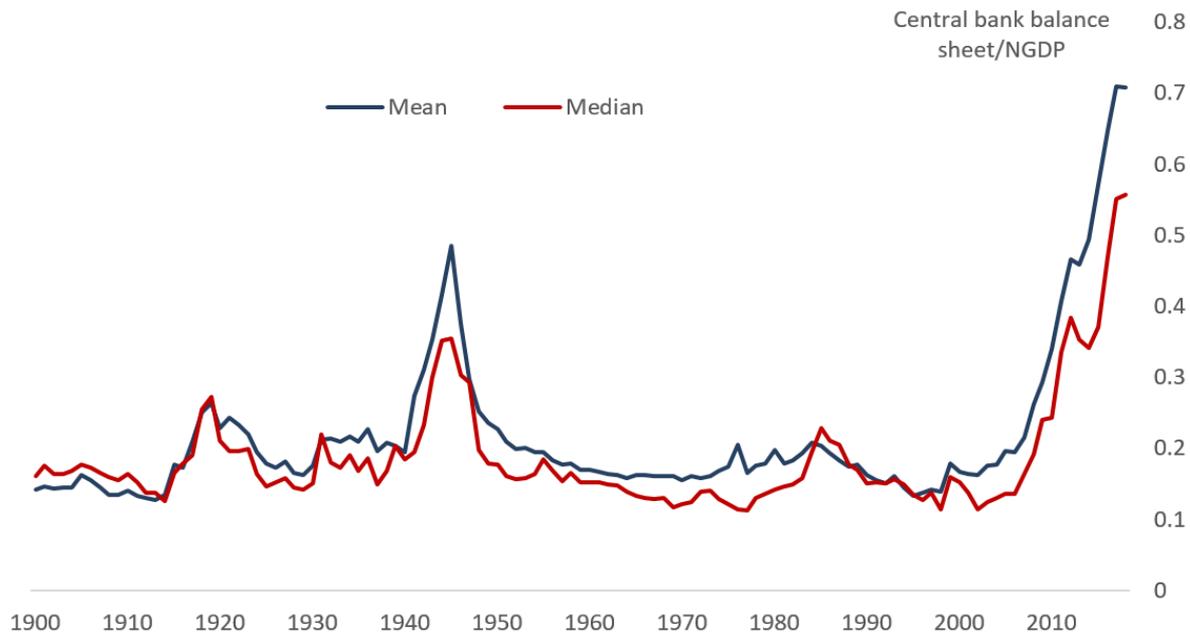
Table 3: RSI and Bank Efficiency

	Measures of efficiency and profitability	
	Net interest margin	Cost to income
RSI Reforms	-0.6	-1.2***
<i>[coefficient range based on robustness checks]</i>	<i>[-1.9 to 0.4]</i>	<i>[-1.8 to -2.4]</i>



Threats to Independence?

Chart 3: Central bank balance sheets relative to GDP



Source: Data from Ferguson, Kornejew, Schmelzing and Schularick (2020). I am grateful to the authors for sharing this data with me. Bank calculations.



Threats to Independence?

- Central bank balance sheet expansions are not monetary financing
- But managing them, and accompanying Government debt, not easy
- Test of independence if inflation – and interest rates? – rises more than expected
- Institutional and legal safeguards then key

