My remarks[1] today will address four key issues that were discussed during the Conference:

- the nature of the recovery that is underway, and the role of monetary policy in this process
- whether monetary policy is over-burdened, and why this may be so
- cross-border spillovers in the current climate
- the scope for international cooperation among central banks.

I should be clear that these remarks are made in the general international setting, not specifically about my own country.

1. The recovery

There was some consternation about the sluggish nature of demand, particularly in the United States. That is a natural point of concern, and an important one. But it is worth remembering that this recovery was always going to be a slow one. That is the nature of a financial crisis. I also noted with interest the view that a number of 'persistent factors' seem to be holding down the level of output – risk-aversion and de-leveraging, among others. It is hard to disagree. I would only note that those processes reflect, at least in part, the reversal of some unusual behaviour that held up the level of output previously.

In this light, there was an interesting discussion of the role of monetary policy in offsetting the 'persistent factors' that are weighing on demand. Participants were suitably candid about the limits of our knowledge – we cannot know the counterfactual. And whilst there is a renewed appreciation that quantities matter, we are still not sure how much of these are needed. There is not much to add here, except that an equally important question is what role monetary policy played in the lead-up to the crisis, in terms of the increase in risk appetite and leverage.

2. Is monetary policy overburdened?

In the second session of the Conference we were asked: 'Is monetary policy overburdened?' The answer seems to be: 'Yes'. But it is useful to reflect on how we got here.

To the extent that the episode is inherently a financial one, central banks were bound to be at the centre of any tactical response, as they should be. The extent of the

[1] Remarks made to the 12th BIS Conference 'Navigating the Great Recession: what role for monetary policy?' Lucerne, Switzerland, 20-21 June 2013.

episode was such that positive interest rate ‘ammunition’ was exhausted, balance-sheet measures became necessary, and central banks entered new territory.

Central banks can act quickly. So when market developments call for a decisive and rapid response it is again only natural that central banks step up. What is more troubling is the sense that, and at more than one key juncture, other policymakers have not only been unable to act quickly, but have been almost unable to act at all. This may have led to the sense that, in moments of crisis, the central bank was the only game in town. I didn’t have the sense that the central banks sought this role, more that they have not been able to avoid it. Either way, some central banks have perhaps been asked to save the day too often.

The paper by Orphanides argued that monetary policy is over-burdened across three dimensions: combatting high unemployment; assisting the pursuit of fiscal sustainability; and promoting financial stability. In some respects, this amounts to a requirement that central banks manage difficult trade-offs. Such trade-offs have always been there. But perhaps the extent and intractability of them has increased. Orphanides makes a persuasive case that there are dangers to the extent that we are asking the central bank to do something that it cannot do, or to make up for the incapacity of others.

We should also keep in mind that monetary policy is not the only policy that is over-burdened. In fact it is overburdened perhaps because some other policies are exhausted.

Public finances are overburdened. Governments are expected to both support growth and to pursue ‘growth friendly consolidation’, whatever that is, whilst back-stopping the banks if need be. Too many countries face acute problems of weak economies, high public debt, and so on. This may have arisen because fiscal policy decisions were weak in the past, but that is not much consolation for those there now. Given the scale of the challenges, there is an obvious desire for some other policy to help out.

One could argue that supervisory and regulatory policies are also overburdened – overburdened by the sheer size of the implementation task and the need for speed, not to mention an expectation that ‘never again’ will one cent of public money be put at risk. To say this all amounts to a very ambitious agenda is a pretty big understatement.

Given all of these challenges, perhaps it is hard to escape central banks being asked to do too much. This is discomforting because it risks politicisation of central banks. There were some sobering comments during this conference that central bank independence is a passing fashion. Let us hope that that is not the case. Making central banks subservient would put at risk their effectiveness, not just because it could un-anchor inflation expectations, but because the same policy paralysis that often seems to afflict fiscal and structural policies could end up applying to central bank policy too.

At its root, the problem here is that policymakers are not that good at understanding how to generate sustained growth. Inability to grow leaves fiscal burdens unsustainable, banks struggling, populations demanding quick and easy answers (hence fostering political instability), and central banks having to pull rabbits out of hats repeatedly.

3. Spillovers

There was some disquiet about the spillovers from the policies of major countries. The presence of these effects is not new; they have always been there. But there are perhaps three unusual factors currently in play.

First, the duration and extreme settings of the major countries' policies is certainly unusual. The relevant policymakers would reasonably argue that circumstances necessitated these measures. However, the limits of our knowledge as to the 'right' quantities, combined with the difficulty in calibrating these balance sheet measures, makes the effects of these policies fertile ground for debate.

The second unusual factor is probably a positive one. Emerging economies have, on the basis of painful experience in the unwinding of other periods of abundant liquidity, become less inclined than they might once have been to simply enjoy the spillovers. They have perhaps worried more about the excesses that can arise and have done some things to try to limit them.

The third factor that I would like to emphasise is that spillovers go in more than one direction. Perhaps more than ever, there are spillovers from the emerging economies to the advanced world. Emerging markets' policies with respect to reserve accumulation are probably big enough to matter and likely played some role in the build-up of imbalances.

Turning to recent developments, we have recently had signals that the Federal Reserve may begin the process of changing direction before too much longer. I would argue that we should welcome the news that the Fed is in this position if it reflects a stronger US economy. When the Fed moves, there will be some disruption. We do not know whether it will be worse than on previous occasions. Reasons to think it might be stem from the unusually extreme position of US settings, and the length of time they have been in place. But, in truth, we cannot know.

Another thing that is perhaps a little unusual right now is the possibility of the Fed shifting course towards, eventually, less accommodation even as the Bank of Japan goes aggressively in the other direction. This may have non-trivial implications for financial pricing especially in exchange markets.

According to Taylor's paper, the argument that quantitative easing (QE) policies in the United States help emerging market economies more than they hurt, because of the rise in US demand, is perhaps not strongly supported by evidence. That would be the subject of debate of course. But if it is right, it must be more so in Japan's case where the domestic dynamism has clearly been weaker than in the United States.

Hence there could be disquiet about the possibility that the only real transmission mechanism that Japan has available is a weaker yen, which would imply Japan is taking away from other countries' growth. Working the other way, the more structural change occurs in Japan, and the more successful they are at moving inflation expectations up a bit, the more Japanese monetary policy will be able to gain traction in Japan itself.

4. Cooperation

So there have, as I say, always been spillovers. But how might we take account of them? Central banks' mandates are framed in national terms, with the obvious exception of the European Central Bank. There can be some informal cooperation, and even formal cooperation on technical matters (such as the US dollar swap lines that were set up during the crisis). But no central bank is going to act contrary to the self-interests of their own country to a material degree for the collective good; they don't have a mandate to do so. The only exception would be if there is agreement at the highest political level in the setting of an international agreement, which would need suitable conditions and safeguards.

Taylor's paper concludes by saying that it would be good to return to the 'rule-like' system that was in place pre-crisis, in which policies seemed pretty sensible and gains from formal coordination small. I would agree. But how likely is it that we can return there any time soon? The first of the troubled countries to start the move would be the United States. Even there, and notwithstanding the recent signals, it will be some time yet before the Fed raises rates. Meanwhile there is Japan, going further with its balance sheet measures. So it seems likely that we will be in an unusual world for a while yet.

Still, if Steve Cechetti's opening remarks are right, we have to think differently anyway if we are to heed his various lessons. One question is whether our rule-like behaviour is only viable if someone is taking care of the various other things that the rules largely ignore. (Or do decision rules have to be more complicated?)

End-piece

Where does that leave us?

Central banking has become more complicated. Even if we do the 'optimal' in the face of our constraints, we may still find our collective goals hard to achieve because the environment is more complex.

Maintaining the perception of independence may be more difficult. The unorthodox measures, and the blurring of the line between monetary and fiscal measures, mean that independence of action may be challenged. The prominence of regulatory tools is also an additional factor: not that we shouldn't use them, but that is another area in which controversy around decisions will inevitably arise.

That is the nature of the world we live in. How, then, might we respond?

We need to be innovative where appropriate but to be suitably modest about how much we know, and acknowledge that the cost-benefit calculations are hard to do. Perhaps in our communication we need to be clear about what central banks can and cannot do.