Ewald Nowotny: Central banking in times of change

Opening remarks by Prof Dr Ewald Nowotny, Governor of the Central Bank of the Republic of Austria, at the OeNB-BIS conference "Central banking in times of change", Vienna, 13 September 2016.

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Ladies and gentlemen,

It is a great pleasure for me to welcome you today to a very special event. The Oesterreichische Nationalbank (OeNB), which was founded in June 1816, celebrates its 200th anniversary this year. To mark this occasion, we organized a number of events. The high-level research conference that will take place today and tomorrow is a further milestone in this series of special events.

The OeNB organized this event in close cooperation with the Bank for International Settlements (BIS). Since its foundation more than 80 years ago, the BIS has provided a forum for the members of our large "family" of central banks to get together and exchange our views and experiences. This is why I was very happy when the occasion arose to join forces with the BIS and organize this high-level policy research conference together. Hopefully, it will provide plenty of opportunities today and tomorrow for policymakers and academics to discuss some of the most pressing questions in present-day monetary policy. I would like to thank Jaime Caruana from the BIS for having made this event possible, and I would like to extend a warm welcome also to Peter Zöllner, former OeNB Governing Board member and thus a former colleague of mine, who is now member of BIS Management– something that does not happen to Austrians every day.

Milestone birthdays not only provide an occasion to gather family and friends. They also afford an opportunity to pause for a moment and reflect on one's past as well as one's plans and hopes for the future. The 200-year history of our institution has been eventful, to put it mildly. In its first 100 years, the Nationalbank was the central bank of a major power; in its second 100 years, that of a small open economy in the middle of Europe. The fate of the Nationalbank has always been closely entwined with the fate of Austria, for better and for worse. Central banks never operate in isolation. The most important lesson to be drawn from our 200-year history is that the greatest threat to financial and monetary stability has been, and still is, war. In fact, it was the twenty odd years of the Napoleonic wars which stood at the origin of the Nationalbank in 1816, as Austria strove to stabilize a currency which had undergone strong inflation and depreciation. So the "privileged Austrian central bank" was founded as an independent institution with private shareholders. One of the first shareholders was Ludwig van Beethoven – and just for the record: this turned out to have been a very good investment for him.

World War I ended with the most dramatic period in Austrian monetary history, the hyperinflation period of the early 1920s. If we can look back on 70 years of prosperity today, this is because of the long period of peace that most of Europe has enjoyed since 1945. The most important ingredient in this success story has been the European integration process, culminating in the foundation of the European Union and the creation of Economic and Monetary Union. Even if the European project faces some headwinds today, we should never forget about these fundamental achievements of the past.

But central banks cannot rest. The world is changing, and so must central banking in order to make sure that we can continue to fulfil our stability mandate. When turning to our hopes and plans for the future, I would therefore like to draw your attention to two developments which have shaped and will continue to shape the evolution of central banking. The first is globalization, the ever-increasing interconnectedness of our economies through the international movement of goods, capital, persons and ideas; a process which we have witnessed for some time now, but which is going to continue unabated. The second, more recent development is the broadening of central bank mandates to include financial stability concerns. Both developments are very closely entangled. And they are both also very much in the focus of the BIS.

Globalization has brought many opportunities, and many of the big challenges facing mankind, like global warming, can in fact only be dealt with at a global level. At the same time, the constraints and influences that result from the interconnectedness of our economies limit the room for domestic policies. The probably biggest change in monetary policy regimes in the past half century – the end of Bretton Woods and the move from fixed to floating exchange rates – resulted from this very tension between the wish to manage domestic economies autonomously on the one hand and a world of increasing capital mobility on the other. But floating exchange rates do not mean that monetary policy is independent. Monetary policy decisions taken in other monetary areas affect our domestic economies and vice versa; more and more so as the global economy is becoming increasingly integrated. The unconventional monetary policies undertaken recently by a number of central banks have created policy challenges in some smaller advanced and emerging market economies. But spillovers concern the main currency areas as well, as exchange rates react nervously to expected changes in their relative monetary stance. As policymakers, we have to take care that the necessary stimulating effect of expansive monetary policies does not so much come from increased net exports but rather from a strengthening of domestic demand. In the present policy environment, which in many ways is still exceptional, it is import- ant to keep the spirit of dialog and cooperation. The BIS has a crucial role to play here by providing a forum for the international community of central bankers. When the BIS was founded in 1930, some 20 central banks subscribed to BIS shares. Today, the BIS counts central banks of 60 countries among its members, representing 95% of world GDP.

A by-product of globalization, namely of financial liberalization and the opening-up of domestic economies and financial systems that we have witnessed over the past 50 years, has been the increasing frequency and severity of episodes of financial instability. Advanced economies had been largely spared by financial crises between 1945 and 1970, or during the "quiet period" as Professor Gary Gorton of Yale University termed it.[1] With the end of financial repression and the forces of financial markets unleashed, central banks now have again to deal with volatile capital flows, booms and busts in credit and asset prices, and banking instability. Historically, it is not new that central banks assume responsibility for financial stability. The U.S. Fed, notably, was founded with the explicit aim to prevent the recurrence of banking crises. Also in the case of the Austrian central bank – even though it was initially founded with the primary objective of fostering monetary stability – financial stability considerations ranked high at a very early stage. Today it is clear – and has been at least since 2008 – that price stability alone is not sufficient to guarantee the stability of the financial system and that the instability of the financial system in turn can seriously undermine the effectiveness of monetary policy and become a threat to price stability.

As a result, we have seen the mandates of central banks evolve. On the one hand, there is the question of whether and how financial stability concerns should enter the monetary policy decision process. As we all know, this topic has received considerable attention at the BIS and will feature prominently in our discussions tomorrow morning. On the other hand, the financial crisis of 2008 has reinvigorated debates on the proper role of central banks in banking supervision and regulation. From the late 1990s onward, there has been a general movement toward creating unified supervisory agencies that would not only be responsible for banks but also for insurance companies and other financial market actors like investment firms. The main advantage of these unified supervisory agencies is their ability to take account of the increasing integration within the financial sector. But who should become the

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[1] Gorton, Gary. 2012. Misunderstanding financial crises. Oxford.

unified supervisor? Some countries like the U.K. – the reform of the Financial Services Authority in 2001 was a landmark event in this respect – but also Germany and Belgium opted for a separate authority outside the central bank. Other countries, like Ireland, assigned unified prudential supervision to their central banks. Overall, however, before the financial crisis there seems to have been some preference for independent financial supervisory authorities, while after the financial crisis more countries went toward putting prudential supervision under the authority of their central banks. In this respect, the most radical changes took place in Hungary, and again in the U.K., where the prudential regulation of financial institutions was integrated back into the Bank of England in 2013.

Both approaches have their advantages and drawbacks. The issue is far from being settled, and in fact there are many reasons to think that there is not one-size-fits-all solution as every arrangement has to work within a specific economic and political context.

It is with these questions in mind that I would like to conclude my introductory remarks and hand over to Jaime Caruana. I wish all of us a successful conference with stimulating presentations and discussions.

Jaime, the floor is yours.