Andrew Bailey: Central Banking in extreme adversity

Speech by Mr Andrew Bailey, Governor of the Bank of England, at the 9th National Bank of Ukraine and Narodowy Bank Polski (NBU-NBP) Annual Research Conference "Economic and financial integration in a stormy and fragmenting world", Kyiv, 20 June 2025.

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Governor Pyshnyy, when you invited me to speak today, I was in no doubt that I was going to be here in person. The UK and Ukraine share unbreakable bonds, which were recognised in the 100 Year Partnership signed in January. That Partnership cements our long-term friendship and lays the foundations for even greater collaboration in areas like science and technology, defence and energy – to go alongside the existing co-operation we have as central banks. As our Prime Minister said when he signed the Partnership, we are closer than ever. But more than that, I am quite simply in awe of what Ukraine confronts as a nation, what you face as a central bank, and how you have conducted yourselves during these most difficult of times.

Of course, it is now accepted good practice that we should all prepare for extreme events, and develop contingency plans to respond to a range of possible scenarios. But our contingency events don't begin to compare with what you have to deal with on a daily basis. To illustrate this point, we have learned from what you do when it comes to serious disruptions to payments systems and to everyday banking business.

Even though I have been determined to be here today, I can't claim – with all humility – to appreciate properly your experience. We must give you all the help we can, and by doing so give a very clear message that our support is unconditional.

Before I joined the Bank of England forty years ago, I was an economic historian. History does matter – you know this painfully well. I don't subscribe to any simplistic view that history repeats itself, but I do believe that there are strands running through history. Long history has shaped your nation. The word nation is critical because the central question is do we share your belief in Ukraine's right to determine its own future. The answer must be yes.

It is also critical to a central bank in your position. Why is that? Modern central banking is built on the independence of the institution. This is critical to our ability to fulfil our objectives. But, we must be clear what this independence means, and what it doesn't mean. We are independent from governments under terms set out in legislation. However we are not independent of our people, the people we serve. Our independence is granted by their representatives in parliaments.

And, our independence extends as far, but not further than, the objectives that we are given by Parliament. Central banks are therefore an emanation of the nation state, and through that the people we serve.

We are responsible and accountable for our objectives. Our legitimacy and authority depend on our accountability. This is the essence of modern central banking. There are typically two objectives of modern central banking – monetary and financial stability. I am going to spend most of the rest of my time setting out how we need to think of them together. But, before I do that, I want to make another important point about our frameworks, which relates to their ability to manage shocks.

These are the real tests of our policy frameworks in respect of monetary and financial stability. It's one thing to develop frameworks in relatively calmer times, but to persist they must be able to stand up and deliver in the face of big adverse shocks.

This has not always been the case in the past. Let me give one example, in the area of monetary policy. The classical Gold Standard emerged to prominence during the nineteenth century. It existed before then, albeit without the same prominence. The nineteenth century was not without economic shocks, but the Gold Standard of the day provided a system in which those shocks could be handled – not always with ease, but still it survived the tests. However, it could not survive the much larger shocks of the period between the two world wars.

In modern times we have combined floating exchange rates and free cross-border capital movements with independent monetary policy oriented towards the domestic objective of price stability. Central to achieving this objective are two things – the independence of the central bank, and a so-called nominal anchor, usually an inflation target which seeks to stabilise the real value of money. We regard this, rightly, as the best way to support activity in our economies. Let me borrow from your web pages: "We care about the welfare of Ukraine and Ukrainians by ensuring price and financial stability as a guarantee of sustainable economic growth".

The real test of these regimes is how well they have stood up to recent shocks. And, do they provide us with a suitable and helpful combination of the rigour of a nominal anchor – the inflation target – with some appropriate flexibility in how we respond to shocks without compromising the anchor? I think the answer is an encouraging yes.

We cannot prevent these shocks from happening – the causes are well outside our control. But we can prevent the inflationary consequences becoming embedded in our economies, and do so without causing consequences which undermine the legitimacy of our framework – avoiding the problem of the classical Gold Standard in the inter-war period. With the important qualification that the job is not, and is never, done, I think we can argue that a focus on domestic price stability and a nominal anchor has proved its worth.

Moreover, the task is both to respond to the shock itself when it hits, and then to the consequences of the shock, which can be quite different. This is where appropriate flexibility and strong transparency and accountability are critical.

Your experience has been extreme in so many respects, including this one. In the face of full scale war you have had to adapt a combination of interest rate and exchange rate policy instruments, FX restrictions and other tools as necessary. But, you have been very clear in public that after the security risks abate and appropriate macroeconomic conditions are established in place, you will return to conventional inflation targeting.

The message is clear. But more than that, and here the comparison with the Gold Standard is relevant, the commitment to get back to the established regime strikes me as both credible and critical.

To conclude, then, we can now start to assess whether the modern orthodoxy of domestic price stability with a nominal anchor in the form of an inflation target is robust in the sense that it can handle severe economic shocks. This is the critical test. And, I think we can be positive here, always accepting that the job is never done.

Let me move on to my second theme. What are we learning about how our two objectives – monetary and financial stability - fit together?

One of the most pleasurable parts of my job is travelling around the UK on a regular basis visiting businesses and hearing about their experiences. When I do this, I try also to visit schools, and speak to students and answer their questions. I usually say a few words at the start to summarise and describe what we do. My opening line is that as the central bank "we are in the money business".

It sometimes gets a smile. Monetary policy, as I have described, is about the real value of money, about price stability and low and stable inflation. It's about confidence in the future of money, the value of money in real terms. Financial stability is about ensuring the future nominal value of money.

Put simply, it is about confidence that the unit of money in one bank account is the same as the one in another bank account at another bank, and likewise that they will be equal to and freely exchangeable with a unit of central bank money, say a banknote. I call this the singleness of money.

It is to ensure this singleness that we pursue financial stability, and in doing so that we regulate banks. And it is why, in my view, these activities have to be in the responsibility of central banks. Unless we pursue and achieve both our monetary and financial stability objectives, we are not fulfilling our role of ensuring the stability of the money system – that's what it means to be in the money business.

It also follows in my view that there is not a hierarchy of our two objectives – one is not more important than the other. Rather, neither can be achieved satisfactorily without the other also being achieved. I can understand how it can seem odd to have to make this point, but to this day I sometimes hear it argued that there is, or ought to be, a hierarchy.

Two important points also need to be made here. The first is that by no means all of the financial system comprises money. Moreover, the share of the non-money system in the total has grown of late. The second point is that there can be evolution in the precise form that money takes. I will consider these two points in turn.

In order to understand the boundaries of money, it helps to define it. I will do this in two, very traditional, ways. The first is the uses of money. There are three: as a unit of account; as a store of value; and as means of exchange. The second definition is about forms of money. We tend to think of two forms of money: money in the accounts of commercial banks – bank deposits; and money in the accounts of central banks –

banknotes and reserve accounts held by banks. Central bank money is also often referred to as fiat money, in the sense that it has the full backing of the state. This is another reflection of the subtlety of the meaning of central bank independence as I described it earlier. It is to the sum of commercial and central bank money that the notion of singleness applies, and it is thus to this sum that ensuring the nominal value is preserved applies.

This said, when we look at the total financial system at present, by most accounts over half of it is not money, in the sense that it is held outside the banking system. We have adopted the term non-bank financial institutions to describe these institutions, or NBFIs for short. I tend to think of NBFIs as the world of investment. It is not a perfect distinction I admit. But the key difference is that when you invest in a non-bank, you do so on the basis that the nominal value of your investment is not assured. This is important, because to grow the economy requires risk taking via investment, quite a bit of which would not be compatible with the assurance of the nominal value of money.

Moreover, a key lesson of the global financial crisis was that banks needed to maintain higher standards of capital and liquidity in order to provide that assurance of nominal value. And it follows from that change to the standards of protection of money in banks, that the non-bank world expanded as some investment assets moved out of banks.

But there are at least three areas of potential difficulty in this arrangement on which we must be focused. The first concerns ambiguity. We have to be on the alert for the development of financial structures which are vague as to whether they are, or are not, inside the money system. In the run-up to the financial crisis, banks created so-called off-balance sheet vehicles which were assumed to be outside the money system.

But when problems hit, they found that investors in these vehicles assumed they were inside the bank, and the bank's own reputation came to depend on them being so. Problems ensued.

The second area of difficulty concerns risks which can originate outside the banking system but then spread into it. Banks and non-banks are often closely interconnected – for instance in financial markets. As the non-bank system grows, so do these connections. This is why we are spending so much more time now assessing the risks that can arise from non-banks. It is one thing to distinguish banks and non-banks in functional terms, but that does not mean they are insulated from each other, far from it.

The third area of difficulty concerns a challenge that does arise nowadays, namely whether we have over-protected the banking system via excessive regulation, and in so doing pushed more risk into non-banks which would be more safely housed in banks. Put another way, have we increased overall financial stability risk by raising the bar too high in banks? It's a fair enough question, but intrinsically hard to answer.

I think the best way to approach this question remains to ask what it takes to preserve the singleness of money, because this is the heart of our concern with financial stability. And the answer is that we have rightly raised regulatory standards for banks in the light of a financial crisis, the effects of which continue to be felt almost 15 years on.

I will end with a few thoughts on the other issue I raised earlier, evolution in the forms of money, and what this implies. Mention of this point is often followed either by the word crypto or by the term digital money. I am not going to do justice to what is a very big issue, but a few points are salient here.

First, a few words on crypto. I see crypto as taking two forms: unbacked assets of the Bitcoin sort, and backed assets of the Stablecoin sort. I think it helps to see these two as distinct. Why? The Bitcoin sort does not have the characteristics of money – critically, it does not purport to maintain nominal value, and thus fails the test of the singleness of money. Instead, it is an investment asset, with no real asset backing, and volatile in price.

It's a risky investment class and should be seen as such. The buyer should beware – so-called caveat emptor applies. Stablecoins are different because they purport to have the characteristics of money and to be usable as such. There is nothing wrong with this, but to pass the test they must provide assurance of nominal value and pass the test of singleness of money. That is perfectly possible to achieve, though I would observe that many of the current versions do not quite achieve that test, not yet at least. In my view we should focus our attention on standards for stablecoins which ensure they do pass the test.

My second thought in the area of the evolution of forms of money concerns so-called digital currency.

What do we mean by this term? After all, money – in the form of central bank reserves – has been digital in form for many years. I think we mean, how do we get the benefits of new digital technologies in the area of payments – where money is a medium of exchange? For instance, how do we get the benefits of smart contracts in payments, and the benefits of using digital technology to fight fraud? I start with the presumption that there should be benefit here – it seems like a failure of imagination if we think otherwise. That said, I remain to be convinced that we need to create new forms of money – such as Central Bank Retail Digital Currency – to achieve this.

By the way, the word retail is important here – we are well on the way to having wholesale central bank digital money, but that is just a natural step on from the wholesale electronic money that we have had for thirty years in our case.

This brings me to my third and final thought in this area. Most payments these days are made in commercial bank money. That's natural – it's the form that all our bank accounts take, and we want to make payments straight from our accounts. Logically, then, if there are real benefits to digital technology in payments, we should want to see them in commercial bank money. The buzzword here is tokenised deposits – a bit of a mouthful, but really it is the application of digital technology to the form of money that we have today. The challenge is to apply this to both domestic and cross-border and cross-border currency payments. To be clear, I am not against stablecoins, but they do have to meet the test of singleness of money. I am not against Central Bank Retail Digital Currency, but I question why it is needed if innovation proceeds as I think it should.

That said, you may detect from what I have said that I do think commercial banks need to step up to the challenge of digital money provision.

Conclusion

To conclude, we are living in a world of much larger economic shocks which have their origins outside economic causes. But, what the rest of us are experiencing is minor compared to the tragedy caused by the illegal invasion of your country. Our independence as central banks is grounded in the nation state and the people we serve. This makes it of critical importance that you can exercise your right to determine your future as a nation. I have set out what I regard as important issues for central banks and their twin objectives of monetary and financial stability.

I wish you every success in addressing these issues as a free, strong and independent Ukraine. And I look forward to a future of strong friendship and collaboration between the NBU and Bank of England, as well as between Ukraine and the UK. Never have we been closer, and we must remain that way.

Thank you.

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