Global Economy

Global political backlash spreads against central banks

Economic danger is greatest in emerging markets where institutions are often weaker

President Donald Trump has ramped up his war of words with the US Federal Reserve, expressing public regrets over his choice of Jay Powell as its chairman © Getty

Chris Giles in London and Sam Fleming in Washington DECEMBER 9, 2018

The technocratic tribe of central bankers is facing political scrutiny of an intensity not seen in decades.

President Donald Trump ramped up his war of words with the US Federal Reserve, accusing it of having " gone crazy " by raising interest rates and expressing public regrets over his choice of Jay Powell as its chairman.

The Reserve Bank of India has been under intense pressure to ease lending conditions, while Hungary has tussled with the EU over measures impinging on its central bank's independence. Turkish president Recep Tayyip Erdogan has shaken market faith in his country by leaning on its central bank to keep rates low.

Even the normal brotherhood of central bankers is fracturing with Mervyn King, former Bank of England governor, accusing his successor, Mark Carney, of "unnecessarily" pandering to the British government's desires over Brexit.

Charlie Bean, former deputy governor to both men, said that such questions over central bank's independence will not go away given the scope of their powers in politically contentious areas. "This area is going to be more fraught in the future than it has been in the past," he said.

Central bankers are likely to be unenthusiastic about such challenges after a decade in which their influence grew because of the crucial role of monetary policy in responding to the financial crisis. But while they are in the eye of the political storm in countries such as the US and the UK, the economic danger is greater in emerging markets where institutions are often weaker and from which money is more likely to flee.

At stake is the trend, which gathered pace in the 1990s, of giving central banks independence to undertake monetary policy.

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Most research suggests the banks have been successful in setting interest rates to smooth the economic cycle. In so doing, they have limited the volatility of inflation without harming economic performance — although they signally failed to prevent the financial crisis.

But in the aftermath of the crisis, Western central banks' use of a broad array of instruments and new powers in areas such as financial stability have triggered a realisation among politicians of just how powerful the technocratic bodies have become.

Recent years have seen a spate of clashes, which can have serious consequences, according to Cristina Bodea, associate professor at Michigan State University, who has studied the issue. She said that "major disagreements between the central bank and the government . . . raise doubts about countries' future prospects" which can show in their credit ratings and subsequent cost of borrowing.

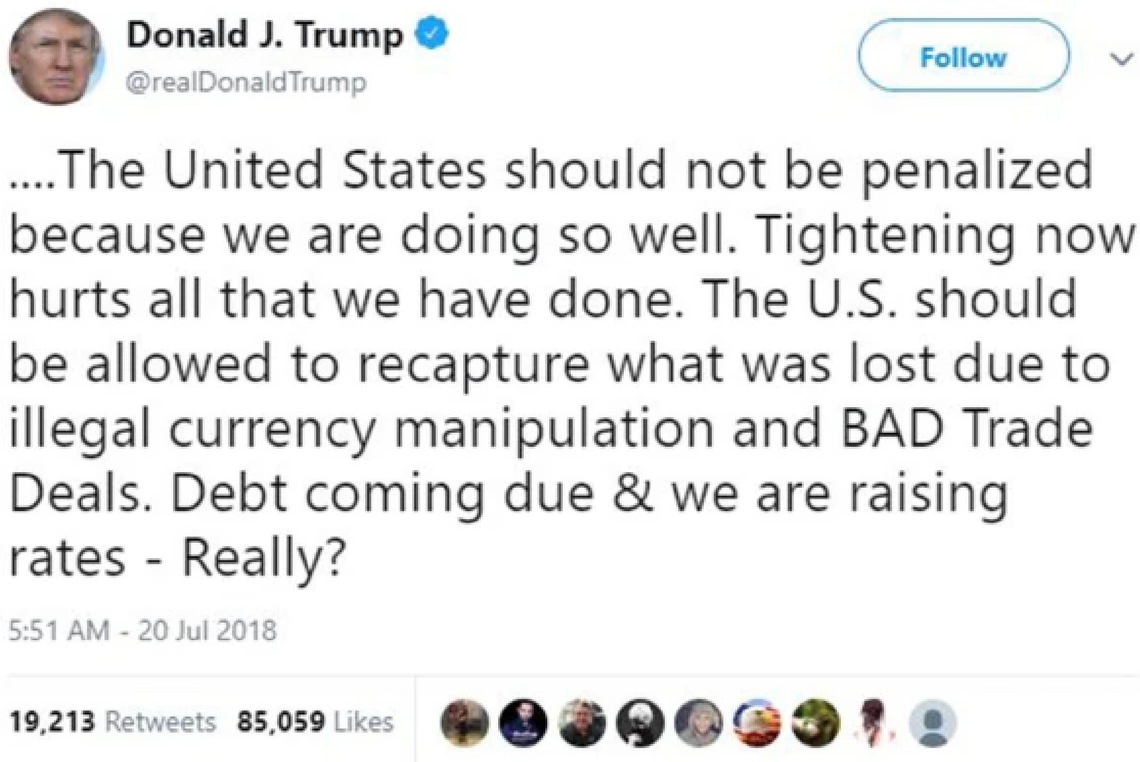
Frederic Mishkin, a former Fed governor who is a Columbia University professor, insisted that the overall trend in advanced and emerging economies remained towards greater independence, not less. He added that it was noticeable that in exceptions such as Turkey, where the lira has slid against the dollar this year, the shift back to greater government control has been "a very bad thing for the economy".

Nevertheless, the view that greater independence is always better is also questioned at the top of the profession.

Raghuram Rajan, a former Reserve Bank of India governor and now a professor at Chicago Booth University, said: "I think as a community, [central bankers] should be challenged and democracy has a right to ask what are you doing and why".

Mr Rajan maintains that greater political interference is inevitable. "The whole political movement is anti-establishment and you aren't going to get more establishment than the central bank," he said.

Whether the new relationship between politicians and central bankers is damaging will depend on the individual circumstances of different countries.



This autumn, President Donald Trump ramped up his war of words with the US Federal Reserve.

In the US, Mr Trump's demands for easy monetary policy have marked a violent breach of precedent. His most recent predecessors all kept quiet about central bank decisions, and previous interventions under Ronald Reagan and George H.W. Bush were largely (though not entirely) kept behind closed doors.

Some Fed veterans are deeply worried by what they see. Janet Yellen, who stepped down as Fed chair at the start of the year, told the FT in October that if the public started losing confidence in the Fed it could trigger Congressional action to rein the institution in.

Yet to date the story of Mr Trump's fraught relations with the Fed has been a mixed one. Don Kohn, a former Fed vice-chair now at the Brookings Institution think-tank, said there was "no evidence" the Trump administration had sought to use its power of appointments to the Fed board to push decisions in a particular direction.

"This is different from the Reagan administration — where they appointed a bunch of people who pushed interest rates lower against [then Fed chair's] Paul Volcker's wishes," he said.

Willem Buiter, special economic adviser to Citigroup, thinks the US president's actions are a reflection of his background as a property magnate and his natural preference for low interest rates.

"The fact that he shoots his mouth off in public about policy rates is rather uncommon in the US but quite common in the euroarea. It is a reflection of Trump the man rather than of any deeper social or political developments," Mr Buiter said.

And while the attacks do not make life easy for the Fed, Jason Furman, a former head of Barack Obama's Council of Economic Advisers, said he expected the central bank to ignore them. "The Fed is filled with professional staff that pay no attention whatsoever to this noise."

Elsewhere things are more serious, Mr Buiter said, with government pressure on the Reserve Bank of India being a prime example of tension.

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The RBI's operational independence has been significantly damaged by concerted attacks by Narendra Modi's government, according to the Brookings Institution's Eswar Prasad. "[It] always hung by a thread even on matters of monetary policy and banking regulation. That thread is now in danger of fraying on account of the government's harsh words and intemperate actions," he said.

Central bankers may seek to respond by stepping up efforts to justify their policies and powers to the electorate. Mr Rajan said this was necessary when he was in charge of the RBI. "I had to make the case for what we were doing," he said.

Letters in response to this article:

Central bankers play a wider political game / From Daniyal Khan, PhD candidate, New School for Social Research, New York, NY, US

Central banks should not set economic policy / From Lord Skidelsky, London, SW1, UK