A welcome defence of central bankers

Few tears are ever shed for bankers and Raghuram Rajan's note "Central banks are the fall guys" is a brave attempt to fight their corner

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Fighting the central banks' corner

Few tears are ever shed for bankers, and the same is probably true of central bankers. Consequently, Raghuram Rajan's note "Central banks are the fall guys" is a brave attempt to fight their corner. Picking up the recent theme of central bank interference by politicians, Rajan makes coherent and persuasive arguments for central bankers to be allowed to do their jobs free of political manipulation. He even has a quick (and perfectly justified) poke at his own erstwhile profession, and the aura central bankers have conjured over what is a very imprecise "science" which at its lowest common denominator descends to the occasional tweak to official policy rates and some public speeches.

Rajan says the central banks' role is far more than this. And of course, he is right. But whilst all the regulatory oversight and market stability legislation is important, the monetary policy decisions central banks take are their most public, and perhaps widest reaching actions. And let's face it, there have been some pretty weird decisions in recent years.

Were central bankers to be a little more open about how limited their powers to influence the business cycle, these unwanted political interventions might well be less common. Central banks would then be less likely to end up hostages to populist leaders, and responding to bad policy-making just to preserve growth and inflation targets.

Former Fed Chairs Alan Greenspan (left) and Ben Bernanke in 2013

Less is sometimes more

In one important area, Rajan does dip his toes into the pool of self-deprecation – notably central bank communication. The section, “The importance of transparency” might indeed have been renamed, “The importance of opacity”.

On this, former Fed chairman, Alan Greenspan was almost certainly right. More communication is not always beneficial, as it is too often stated and taken for granted. But rather than Rajan’s focus on demystifying monetary policy and the “pointy heads” of Basel, less communication might be beneficial for markets mainly because in recent years, central banks have repeatedly demonstrated that their forward guidance is an inferior steer compared to the combined wisdom of markets. This may owe to little more than the “wisdom of crowds”. But what is clearly needed is not “more communication” but “better” communication. And that may mean “less” when central banks own insight is no better than markets.

In short, one way to get the populist leaders off the backs of central banks would be to adopt a little more humility about their powers of cycle stabilization. In that vein, a little less “guidance” might also result in less distortion in financial and real asset markets than exists today.

ING's Rob Carnell was responding to this article by the economist Raghuram Rajan which appeared on our THINK website on 2 August

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