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Central bank independence since the financial crisis: The Swiss perspective

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Introduction

'The Old Lady' has been around for more than 300 years, but has only been independent for the last 20. I am of course referring not to an individual but an institution. True to its nickname, the Bank of England is one of the oldest central banks in the world. It was founded in 1694, but only became independent of the Treasury 20 years ago, on 6 May 1997. However, the Bank of England was not the only central bank to experience an institutional overhaul in the 1990s; the Bank of Japan's independence would be crucial to the 1997 revision of the Bank of Japan Act, too. Equally, ensuring that independence was firmly anchored in law was a top priority for the founders of the European Central Bank (ECB). Generally, the 1990s were a high-water mark in the global trend towards greater independence for central banks.

To understand this trend, we have to rewind to the 1970s and 1980s, when many countries were suffering from high inflation. During both of these decades, average annual inflation in the OECD countries stood at over 9%. And yet, some central banks performed relatively well despite the unfavourable environment. In Germany and Switzerland, for instance, average inflation during this period was 'only' around 4%. The fact that the Bundesbank and the Swiss National Bank (SNB) enjoyed a high degree of independence from political interference seems to have played an important role here. In the early 1990s, a series of empirical studies confirmed that there is indeed a close link between central bank independence and inflation performance, and that this does not negatively impact an economy's growth.[1]

In addition to these empirical findings, theoretical studies were published around this time demonstrating why independent central banks are better positioned to deal with high inflation. When governments set monetary policy themselves, a bias to higher inflation – the so called 'inflation bias' – frequently ensues. There are a number of reasons for this. Governments may, for instance, opt to finance public expenditure by printing money, thereby fuelling inflation. But even if they do not resort to such explicit measures, the incentive for governments to give the economy a short, sharp boost via expansionary monetary policy can be considerable, especially in the run-up to an election. Another driver of the inflation bias relates to the fact that governments are typically more proactive about intervening with stabilising measures during recessions than during periods when the economy is overheating. They tend to delay taking unpleasant but necessary action, such as tightening monetary policy, and this pushes up inflation.

[1] Cf. overview in Cukierman, A. (2008), Central bank independence and monetary policymaking institutions – past, present and future, *European Journal of Political Economy 24,* pp. 722–736. On the relationship between central bank independence and growth, cf. Grilli, V., Masciandro, D. and Tabellini, G. (1991), Political and monetary institutions and public financial policies in the industrial countries, *Economic Policy 13*, pp. 341–392; Alesina, A., and Summers, L.H. (1993), Central bank independence and macroeconomic performance: some comparative evidence, *Journal of Money, Credit, and Banking 25(2),* pp. 151–162; and Cukierman, A., Kalaitzidakis, P., Summers, L.H. and Webb, S.B. (1993), Central bank independence, growth, investment and real rates, *Carnegie-Rochester Conference Series on Public Policy 39*, pp. 95–140.

The theoretical studies show that independent central banks whose mandate is geared towards price stability are not subject to the same ‘incentives’ as governments, because they are not exposed to the forces of competition at play in the political contest. Hence, delegating monetary policy to an independent central bank reduces the inflation bias and simultaneously supports an economy’s growth over the long term.[2]

These empirical and theoretical findings were decisive in the crystallisation of a broad consensus during the 1990s – namely, that central bank independence is a key prerequisite both for successful monetary policy geared towards price stability and for healthy economic growth.

By and large, these expectations regarding the positive effects of central bank independence turned out to be well founded. Inflation in the advanced economies declined to a low and stable level. Annual inflation in the OECD countries between 1990 and the beginning of the financial crisis averaged just over 4%, less than half the rate recorded during the 1970s and 1980s. At the same time, independence had a positive effect on the macroeconomic environment and contributed significantly to the reduction in business cycle volatility known as the ‘Great Moderation’: monetary policy became more predictable and thus, from the public’s perspective, more ‘boring’ than it had been in the past. It was no longer itself the cause of economic disruptions. Moreover, the global economy benefited from the fact that there were no major shocks during this period. Overall, these favourable developments strengthened the case for central bank independence – and the notion was therefore largely undisputed.

All this changed when the financial crisis hit. The financial markets and the banking system were severely shaken and many economies experienced a period of profound upheaval. A monetary and fiscal policy response was called for. Monetary policy in particular was mobilised on an unprecedented scale, and new and unconventional instruments were deployed. Central banks were also presented with additional tasks, for instance in relation to financial stability. While the central banks were initially admired as knights in shining armour, this attitude changed as it became clear that the economic difficulties were more entrenched. The unconventional nature of the monetary policy measures and the broadening of central banks’ remit prompted growing criticism. The objections have varied widely depending on the country and precise situation concerned: some claim that central banks have gone too far and have deviated from their core, legally mandated tasks; others complain that they have been too cautious and have done too little to support the recovery. And again and again, people express unease at what they see as a concentration of power within central

[2] On the problem of political pressure, cf. Ricardo, D. (1824), *Plan for the establishment of a national bank*, London, John Murray. As regards time inconsistency, cf. Kydland, F.E. and Prescott, E.C. (1977), Rules rather than discretion. The inconsistency of optimal plans, *Journal of Political Economy 85(3)*, pp. 473–492; Calvo, G.A. (1978), On the time consistency of optimal policy in a monetary economy, *Econometrica 46(6)*, pp. 1411–1428; and Barro, R.J. and Gordon, D.B. (1983), A positive theory of monetary policy in a natural rate model, *Journal of Political Economy 91(4)*, pp. 589–610. For an approach to controlling inflation bias (‘conservative central banker’ theory, e.g. it is optimal to appoint a central banker who is more averse to inflation than society as a whole), cf. Rogoff, K. (1985), The optimal degree of commitment to an intermediate monetary target, *The Quarterly Journal of Economics 100(4)*, pp. 1169–1189. On the problem of ‘inflation bias’ in the presence of asymmetric preferences, cf. Jordan, T.J. (2001), *Inflation bias, output stabilization, and central bank independence*, Berne, Verlag Paul Haupt.

banks. In short, the subject of independence is being much more actively debated by the public today than in the past. Have the central banks gone too far? Is independence still justified? Is central bank independence even threatening the balance of powers and the democratic process in certain countries or currency areas?

These questions are crucial for the legitimation of central bank independence – both now and in the future. So I'd like to explore them in a little more detail. I shall analyse the situation from the central banker's perspective and draw on our experiences in Switzerland.

As you might expect, I am convinced that central bank independence is essential even after the experience of the financial crisis, both for maintaining price stability and for ensuring stable and healthy economic growth. It is crucial not only during fair-weather phases such as the Great Moderation but also – and in particular – during turbulent times. Having the latitude to make rapid decisions and deploy the relevant instruments as required is in the interests of the whole of society, most especially during periods of crisis.

However, in a complex macroeconomic environment it is particularly vital that central banks systematically explain and justify their actions on a regular basis. They must be able to demonstrate the benefits of independence to the population and show that they exercise the power entrusted to them responsibly. Central bank independence is not a given; it has to be earned – and this is a continuous process.

Central bank independence in Switzerland

Let me first say a few words about the institutional framework in Switzerland.

In Switzerland, the SNB's independence is enshrined at the very highest level – in art. 99 of the country's Federal Constitution – reflecting the importance the state ascribes to the central bank's independence. The specific scope of this independence is defined in the National Bank Act (NBA) and encompasses four dimensions: functional, institutional, financial and personnel-related.

Functional independence is understood to mean that the SNB shall be allowed to fulfil its mandate free of any instructions, notably from the Federal Council and the Federal Assembly. The SNB is an independent institution in the sense that it has its own legal personality as a special-statute joint-stock company.[3] The financial independence of the SNB comprises two aspects: first, a ban on state financing; and second, budgetary autonomy. Finally, with respect to personnel, the SNB's independence stems from the fact that the members of the Governing Board, the committee responsible for setting monetary policy, are appointed by the Federal Council for a fixed and comparatively long term of six years. Furthermore, a member of the

[3] Over half of the SNB's share capital is held by public shareholders (mostly cantons and cantonal banks); the remainder is owned by private individuals. The Confederation holds no shares. No shareholder or group of shareholders may influence monetary policy decisions. Moreover, the voting rights of private shareholders are limited to 100 shares.

Governing Board can only be removed from office if he or she no longer fulfils the requirements for exercising the office or has committed a grave offence.

This high degree of independence supports the SNB in the fulfilment of its mandate. According to the constitution, the SNB must conduct monetary policy in such a way that it serves the interests of the country as a whole. The NBA spells out the SNB's mandate in detail, stating that its role is to ensure price stability while taking due account of economic developments. In addition to this, the SNB must contribute to the stability of the financial system and is responsible for a range of other tasks, such as guaranteeing the supply and distribution of cash.

The SNB has operationalised its monetary policy mandate as follows: it defines price stability as a rise in the national consumer price index of less than 2% per annum (equally, deflation is regarded as a failure to meet the price stability objective); and price stability is understood as a medium and long term concept. This makes sense given that, as a small open economy, Switzerland is often influenced by economic developments abroad, which in turn directly lead to fluctuations in the price level.

The counterweight to the SNB's independence is its duty of accountability; this too is laid down in the NBA. The SNB holds regular discussions with the Swiss government, participates in consultations with parliamentary committees and publishes an annual accountability report. The SNB's duty of accountability also includes providing the public with regular and comprehensive assessments of the economic situation and supplying detailed explanations of its decisions. The SNB accomplishes this via press releases, news conferences, speeches and interviews as well as a large selection of material on its website. In 2016, for example, the members of the Governing Board had discussions with Swiss parliamentary and other government committees on 12 occasions. The Governing Board also informed the public about monetary policy and other central banking topics at approximately 100 events. Ongoing and intensive communications work with the public is particularly important in a direct democracy like Switzerland. Under such a system, the electorate has the right to organise popular initiatives and, potentially, to force a public referendum on substantive issues, including matters of relevance to monetary policy.[4]

[4] Examples include the 'gold initiative', which the people and cantons rejected in a referendum in November 2014, and the 'sovereign money initiative', which has yet to be put to a vote.

Central bank independence in the aftermath of the financial crisis

What is it exactly that has ignited discussion and debate about central bank independence since the financial crisis? To analyse the various issues, I would like to start off with some fundamental aspects, in particular the wording of the mandate. I will then go on to discuss some questions that have arisen in recent years specifically in the areas of monetary policy and financial stability.

Fundamental aspects

A clearly defined mandate and the assessment of its fulfilment are crucial for the democratic legitimation of an independent central bank. Theoretical studies on central bank independence often start from an idealised vision in which the central bank's mandate can be precisely defined and its fulfilment easily measured using statistical parameters. The goal in these models relates to one or two economic factors, which in turn can be precisely controlled by a monetary policy instrument. In this world of models, the public can check at any time whether the target has been achieved.

Reality though, as the financial crisis recently brought home to us, is considerably more complex. On the one hand, central banks' mandates often comprise several goals, such as price stability and financial stability. On the other, the mandate is generally more broadly formulated than in the simple model assumptions. In the real world, a central bank mandate outlines the basic concepts by which the institution's actions must be guided and does not specify any decision-making rules that can be mechanistically applied to every possible future situation. As a result, central banks have flexibility, which can be very useful in the face of a swiftly and sometimes abruptly changing environment. They also need to be able to react with new instruments if this is appropriate. It is simply not possible to specify in advance every single instrument – let alone the precise policy to be applied – for every conceivable scenario.

In contrast to an idealised world, the scope of influence of central banks is also limited to an extent depending on the circumstances. There is often significant uncertainty with respect to the current and future situation and to the effect of the instruments deployed. Thus, inflation and economic developments cannot be strictly controlled. Furthermore, the use of certain instruments can entail longer-term risks and costs, aside from the short-term benefits. In the midst of such uncertainty and conflicting interests, central banks have to take decisions to the best of their knowledge and belief. The expected benefit of a measure needs to exceed the associated costs, both current and anticipated. In order to ensure that the available instruments are used appropriately, it is an absolute prerequisite that the benefits are carefully and comprehensively weighed against the costs within the scope of the mandate. For instance, not every short-term deviation from price stability or full employment should serve as justification for action, especially if this jeopardises the attainment of long-term goals. Ensuring medium and long-term target achievement in the interest of society as a whole should always be paramount.

To justify their decisions and ultimately their independence, central banks have to be fully accountable. They need to inform on the rationale underlying their actions and the contribution their measures make to the fulfilment of their mandate. In particular, they need to explain the benefits and the risks involved, and make clear what can actually be achieved under the given circumstances.

How do these fundamental considerations help us to interpret the actions of central banks since the onset of the financial crisis? I shall begin by answering this question in relation to monetary policy, and then go on to consider financial stability.

Monetary policy aspects

So let me now turn to monetary policy. I would like to highlight three aspects in particular that are often taken as grounds for challenging the independence of central banks: unconventional monetary policy measures, the resulting expansion in central bank balance sheets, and potential side-effects of monetary policy measures. I will discuss these points of criticism in turn, based on our specific experiences in Switzerland.

Once interest rates in many countries had been lowered to zero due to the financial crisis, the conventional interest rate instrument could no longer be applied. In order to continue to combat the crisis, unconventional measures came to be deployed. One example is 'forward guidance' – communication about the likely future course of short-term key rates. Some central banks also used quantitative easing in the form of large-scale purchases of medium and long-term securities.

Did central banks overstep their mandate with the scope and focus of these unconventional monetary policy measures? As I described earlier, central banks' mandates are, to a certain degree, deliberately formulated in basic terms only. They cannot be expected to describe and define in advance all possible economic constellations and the appropriate measures to be applied in each case. Every new situation requires central banks to act in line with the basic concepts of their mandate while weighing any trade-offs involved and being able to react swiftly whenever necessary. This approach clearly proved its worth in the financial crisis.

Let me illustrate this based on our experience. In Switzerland too, we adopted unconventional monetary policy measures. Despite several interest rate reductions following the onset of the financial crisis, the Swiss franc appreciated sharply due to its perceived role as a safe haven in periods of heightened uncertainty. This led to a tightening of monetary conditions and was exactly the opposite of what was required in view of the risk of deflation during the crisis. The SNB intervened in the foreign exchange market to absorb the shocks from abroad and ease the pressure on the Swiss franc. In a further development, the SNB introduced a minimum exchange rate of CHF 1.20 per euro in September 2011. It was conceived as a temporary instrument since a permanent peg of the Swiss franc to the euro would have been irreconcilable with the SNB's mandate. In January 2015, we discontinued the minimum exchange rate and simultaneously lowered the interest rate on sight deposits held at the SNB

to –0.75%. Since then, our monetary policy has been based on two elements: the negative interest rate and our willingness to intervene in the foreign exchange market if necessary.

Initial criticism of unconventional monetary policy in Switzerland was levied at our interventions in the foreign exchange market. Some claimed that the SNB had allowed the Swiss franc to appreciate too sharply. Others would have preferred that we had adhered to flexible exchange rates and not taken steps to influence them. I don't want to go into each episode individually. But, as an example of central bank policy, let me explain the discontinuation of the minimum exchange rate in a little more detail.

In the second half of 2014, the euro began to rapidly and sharply depreciate against all currencies because the market was increasingly expecting the ECB to launch an asset purchase programme. Although this was a euro-specific development, the minimum exchange rate to the euro also caused the Swiss franc to weaken against key currencies, in particular against the US dollar. The financial markets recognised that this depreciation was leading to distortions in the exchange rate system, and demand for Swiss francs rose sharply at the beginning of 2015. It was clear that constant interventions of rapidly increasing magnitude would be needed to enforce the minimum exchange rate. The situation had thus radically changed and we needed to review our monetary policy.

What were the arguments for discontinuing the minimum exchange rate? Our sudden exit enabled us to prevent an explosive expansion of the SNB's balance sheet. Continuing to uphold the minimum exchange rate without due consideration of the changes at international level would have called the SNB's credibility into question. In light of the new conditions with broad-based euro weakness, absorbing the pressure on the minimum exchange rate on a sustainable basis was no longer feasible, even with high levels of intervention. The benefit of this realignment of monetary policy was that it enabled us to retain our ability to act in the future. The costs were an immediate appreciation of the Swiss franc and a period of lower growth and negative inflation. We would have incurred these costs anyway – indeed they would probably have been even greater – had we delayed discontinuing the minimum exchange rate.

Weighing up our choices showed us that we had no alternative but to discontinue the minimum exchange rate. We therefore had to accept the associated short-term costs in order to fulfil our mandate in the medium and long term. Thanks to our independence, we were in a position to react quickly to a new and extremely difficult situation. Of course, I can't deny that this move took some courage – after all, it is easier just to put difficult decisions off.

Further depreciation of the euro against the dollar following the discontinuation of the minimum exchange rate confirmed to us that we had made the right decision. With the realignment of our policy, now based on the negative interest rate and our willingness to intervene on the foreign exchange market as necessary, we were able to absorb some of the adverse effects of the discontinuation of the minimum exchange rate. Inflation is now back in positive territory. Although the appreciation of the Swiss franc at the beginning of 2015

signified a substantial and often painful burden for many export-oriented companies, it did not culminate in a recession, and the slight rise in unemployment was only temporary.

As in the case of other central banks, one consequence of our monetary policy measures has been the significant expansion in the balance sheet total.[5] A large number of voices are now demanding – and this is the second aspect of monetary policy where central bank independence is challenged – that politicians rather than the central bank should decide how the assets are invested. As far as the SNB is concerned, there are a host of proposals suggesting, for instance, that its assets be invested in innovation-promoting or domestic infrastructure projects. Losing control of one's own assets, though, would inevitably lead to a politicisation of monetary policy and would therefore strike at the heart of central bank independence. Sovereignty over our monetary policy and over our own balance sheet are indivisible. The central bank must be able to choose a balance sheet structure that maximises its room for manoeuvre in current and future monetary policy.

The large balance sheet provokes discontent not just in relation to investment policy, but also because of the strong fluctuations in our annual results. In some circumstances, these can lead to no dividend being paid to shareholders and no distributions being made to the Confederation and the cantons. Withstanding the pressure that can result from this link between monetary policy and distributions is another reason why central bank independence is hugely important. Profits and the associated distributions can never be the goal of monetary policy, they are merely a by-product.

One final aspect that leads to the SNB's independence being called into question concerns the potential side-effects of unconventional monetary policy measures. In Switzerland, the negative interest rate, in particular, has been heavily criticised. People initially found it very hard to accept the idea of negative nominal interest rates, and some critics thought that the SNB had taken its independence too far. We have made great efforts to explain the need for negative interest rates in Switzerland, repeatedly pointing out that, without this measure, the Swiss franc would be too attractive as an investment currency in the current global interest rate environment and would start to appreciate again. Only thanks to the negative interest rate have we been able to partially restore the traditional interest rate differential with other currencies.

Our experience in this context shows once again how crucial it is that central banks clearly explain their monetary policy and what it can achieve to the general public at every opportunity. This applies not just to unconventional monetary policy, but to all their fields of activity. Only full accountability can give legitimacy and endurance to central bank independence.

[5] As a result of foreign exchange market interventions, the Swiss central bank's balance sheet total grew from CHF 110 billion at end-2006 to CHF 775 billion in mid-2017. The SNB's balance sheet total today is thus higher than Switzerland's nominal GDP.

Financial stability aspects

I would now like to turn to another important responsibility of central banks – financial stability. Here, too, the question is whether central banks should fulfil certain associated tasks independently and on what mandate this is based.

I shall start by describing the division of responsibilities, before moving on to the issue of how to formulate a mandate for financial stability; once again, my remarks will be informed by the Swiss perspective.

In order to enhance financial stability, there has, since the financial crisis, been a greater focus on strengthening the resilience of the financial system as a whole and on avoiding the build-up of systemic risk. This macroprudential approach is based on the insight that bank-level microprudential regulations are not sufficient to guarantee the stability of the financial system as a whole. Interdependencies between banks and their procyclical behaviour must also be taken into account when designing measures to maintain financial stability.

So what should the division of macroprudential responsibilities look like?

Whereas microprudential oversight is clearly the remit of banking supervision authorities, macroprudential analysis calls for a broader, macroeconomic perspective. Central banks are used to taking this perspective and are thus well versed in distinguishing between cyclical developments and medium-term trends. This experience can be very valuable when it comes to assessing the build-up of imbalances in the financial sector. However, there can be no guarantee that such an assessment will prove correct in every case. Here, too, central banks make no claim to infallibility.

On the financial stability front – as in monetary policy – certain incentives to postpone unpleasant decisions may be in play; after all, deploying macroprudential instruments can be unpopular. It is, for example, quite possible that measures to curb excessive borrowing for the purchase of real estate would be opposed by a broad alliance of banks, real estate agents, the construction industry, property owners and potential buyers. Entrusting macroprudential responsibilities to an independent institution could reduce the risk of fundamentally necessary measures being taken late, or not at all.

However, the fact that macroprudential measures often have powerful distribution effects would speak against handing over the entire responsibility for such instruments to the central bank. In contrast to monetary policy, macroprudential instruments are targeted at specific sectors and groups. Take debt limits for private households, for example. Such measures also have fiscal implications and therefore require democratic legitimation. If the responsibility for this type of instrument were to lie solely with central banks, the lack of democratic legitimacy would call their independence into question over the medium term. This is why the government should play a key role in designing the framework for such measures.

In practice, several players are often involved when it comes to financial stability. Alongside the central bank, these are typically the financial market supervisor and the government, which is generally represented by the finance ministry. In Switzerland, legislators have

divided the tasks between the government, the Swiss Financial Market Supervisory Authority (FINMA), and the SNB. Specifically, the SNB is responsible for assessing the systemic importance of banks and financial market infrastructures, and it also plays an important role in introducing and adjusting measures aimed at reducing cyclical risk. One such measure is the countercyclical capital buffer, which was introduced in 2012 and has been activated since 2013. It requires banks to gradually increase their capital base in the event of imbalances being observed on the credit markets. Whenever the SNB deems it necessary to adjust the buffer, it consults with FINMA and then submits the relevant proposal to the government. Thus, while all three institutions are involved, it is the SNB that takes the initiative to deploy the measure.

Since various entities are involved in ensuring financial stability, it is important that their respective tasks are defined as clearly as possible. If the responsibilities are not clearly demarcated, there is a risk that, when a crisis occurs, pressure on the central bank will increase should other institutions prove unable or unwilling to act. The bank might then feel obliged to implement measures for which other entities ought really to be taking responsibility.

In 2012, 'too big to fail' legislation was passed in Switzerland, which alleviated this problem. It aimed to prevent situations in which systemically important financial institutions have to be bailed out. Bank bailouts of the kind witnessed during the financial crisis pose a latent threat to central bank independence. Initially, the central bank may be hailed as a saviour, but as soon as the dust has settled, the question of whether it has overstepped its mandate is usually raised.

This brings me to my second point – the difficulty of formulating a workable mandate for managing financial stability. As with monetary policy, the aim is to define a mandate so as to ensure that both the central bank and the public clearly understand the principles behind any action taken. The fundamental reasoning behind the central bank's actions must be unmistakably clear. Again as with monetary policy, however, it remains impossible to prescribe specific steps for all possible scenarios. After all, future financial crises can never be predicted with any certainty, nor can fitting measures be determined in advance.

Moreover, when formulating the financial stability mandate, the possibility of a conflict of interest with the price stability mandate must be borne in mind. Central banks could face a situation in which the goals of price stability and financial stability demand contradictory measures. Conflicts of interest could also stifle a central bank's ability to fulfil all the tasks it has been charged with, which could lead to its independence being called into doubt. This is why an unambiguous formulation of the goals in the central bank's mandate is not enough. There must also be clarity about which goals take priority.

In Switzerland, legislators have laid down clear priorities in this respect. The mandate of price stability takes precedence over that of financial stability. This rule helps the SNB to weigh the trade-offs involved when there is a conflict of interest and to make appropriate decisions.

In the context of financial stability, too, a central bank's independence and the fact that its mandate is formulated in general terms only are counterbalanced by the duty of accountability. This represents a special challenge, as defining the goalposts for financial stability is harder than for price stability. Whereas discussing and explaining inflation targets is fairly straightforward, a definition of financial stability is more elusive. Does the absence of a banking crisis constitute financial stability? How can we assess whether the macroprudential measures taken are effective and appropriate?

There are no simple answers to these questions. The best a central bank can do is to communicate its appraisal of the situation and the risks as precisely as possible and to explain the trade-offs involved in any decision to deploy macroprudential measures. In Switzerland, we supply details of our financial stability policy in our regular accountability reporting. Furthermore, we publish an annual stability report, in which we assess the resilience of the Swiss banking system, issue recommendations and explain any measures we have taken.

How can central bank independence be ensured in future?

Taking Switzerland as an example, I have shown how public perception of central bank independence has shifted since the financial crisis. Our experience has reinforced my conviction that central bank independence remains both sensible and necessary. Central banks can best fulfil their mandate of ensuring price stability and contributing to the stability of the financial system if they are protected from political pressure. And this requires independence.

Nevertheless, this independence is always liable to be challenged. Central bank independence is not a given, and may therefore justifiably be called into doubt at any time. It will only endure as long as politicians and the public are convinced of its benefits and trust that their central bank exercises the power vested in it responsibly. Independence must thus continuously be earned anew.

What can central banks themselves do in this respect? First of all, they must strive to convince society that the current arrangement is, in the long term, advantageous for all. To this end, they must do their utmost to fulfil their mandate to the best of their knowledge and ability; this, ultimately, is the optimal way for an independent central bank to reinforce its credibility. However, in pursuing this goal, a central bank must be careful to keep things in proportion. This is why every decision should be preceded by a thorough analysis of the trade-offs involved over the long term. Not every short-term deviation from an objective requires an activist response.

Moreover, as a counterweight to its independence, a central bank must be prepared to report in detail on its actions, the motivation behind them, and the results. Specifically, it must regularly provide comprehensive information on how any measures taken contribute to the fulfilment of its mandate. Equally, such explanations must spell out what is realistically achievable under a given set of circumstances – and at what cost.

A central bank must therefore have a clear understanding of what it can and cannot do; being conscious of our limits is part and parcel of the prudent handling of our responsibility. An accumulation of tasks should thus be avoided. Just because a central bank can assume additional tasks does not mean it should. Monetary policy cannot and should not encroach into areas for which politicians are responsible. Being entrusted with tasks beyond its core competence may seem attractive to a central bank in the short term, however in the medium and long term, taking on additional responsibilities has the potential to jeopardise a central bank's independence.

So let me sum up: central bank independence is only a means to a higher end. As long as its effects are beneficial to society, and as long as this fact can be clearly communicated to the outside world, there will be broad acceptance of the institution's independence. To this end, central banks must explain the significance of independence for the fulfilment of their mandate on a continuous basis – and in realistic and understandable terms. This is the best way to ensure that independence is preserved in the interests of society as a whole.