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In this issue

Inflation is falling gradually in most of the countries under review − mainly on account of energy prices − but remains at high levels well above inflation targets. Central banks in Central Europe (NBP, MNB, CNB) left their interest rates unchanged, while the other central banks we monitor raised their rates further over the past three months. However, the Fed also kept rates unchanged at its latest meeting in June, although it also announced that they were likely to be raised at future meetings. The turmoil in the banking sector has calmed at least for the time being and the Fed is evaluating why SVB collapsed.

Spotlight discusses monetary policy reviews, focusing on those conducted over the past year or currently underway at Australia's RBA, New Zealand's RBNZ, Japan's BoJ and UK's BoE. In our *Selected Speech*, ECB President Christine Lagarde discusses the fragmentation of the global economy into competing blocs and its impact on the policy environment for central banks.

This publication aims to provide economists and other specialists with information on the latest monetary policy developments, strategies and communications at selected central banks.

Current and past issues can be downloaded free from the *Monetary policy* section of the CNB website: https://www.cnb.cz/en/monetary-policy/monitoring/, where you can also download a file containing a list of all the thematic articles and speeches.

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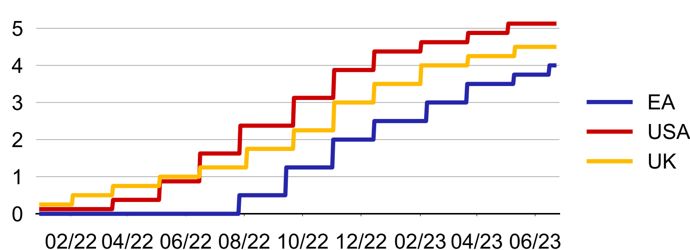
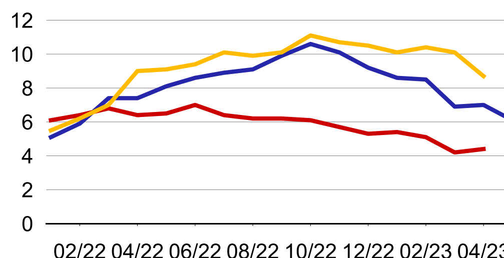
I. LATEST MONETARY POLICY DEVELOPMENTS AT SELECTED CENTRAL BANKS

I.1 KEY CENTRAL BANKS OF THE EURO-ATLANTIC AREA

	Euro area (ECB)	USA (Fed)	United Kingdom (BoE)
Inflation target	2%	2%[1]	2%
Publication of MP decisions (rate changes)	4 May (+0.25) 15 Jun (+0.25)	22 Mar (+0.25) 3 May (+0.25) 14 Jun (0.00)	23 Mar (+0.25) 11 May (+0.25)
Current basic rate	4.00%	5.0–5.25%[2]	4.50%
Latest inflation	6.1% (May 2023)[3]	4.4% (Apr 2023)[4]	8.7% (Apr 2023)
Expected MP decisions	27 July 14 Sep	26 Jul	22 Jun 3 Aug

Note: [1] as measured by PCE (Personal Consumption Expenditures) index; [2] chart shows centre of band; [3] flash estimate; [4] PCE index.





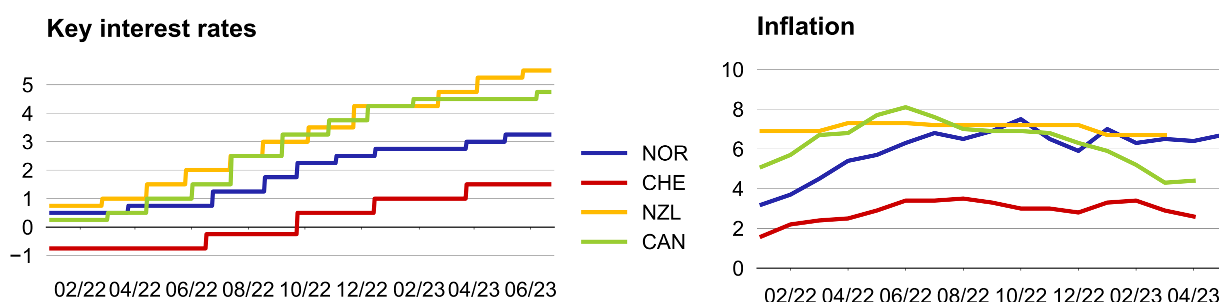
The **ECB** raised its rates by 25 bp at both the May and June meetings. According to the June projections, headline inflation will average 5.4% in 2023 and fall gradually to 2.2% in 2025. Indicators of underlying price pressures remain strong, although some show tentative signs of softening. The forecast for core inflation has been revised up, especially for this year and the next, whereas the euro area GDP growth forecast has been revised slightly down. According to the ECB, past rate increases are being transmitted forcefully to financing conditions and are gradually having an impact across the economy. Borrowing costs have increased steeply, causing growth in loans to slow. The ECB considers tighter financing conditions a key reason why inflation is projected to decline further towards the target, as they are expected to increasingly dampen demand. APP asset holdings are declining in line with the previous plan. Reinvestments under the APP will be discontinued as of July 2023. As concerns the PEPP, the Governing Council intends to reinvest the principal payments from maturing securities purchased under the programme until at least the end of 2024.

Following two hikes of 25 bp, the **Fed** left the target range for the federal funds rate unchanged at 5.0–5.25% in June. Recent indicators suggest that economic activity has continued to expand at a modest pace. Job gains have been robust in recent months, and the unemployment rate has remained low. The US banking system is sound and resilient. Although inflation has eased compared with last year, it is still elevated and it will take some time to get to the target. High inflation pressures persist in the economy, but long-term inflation expectations seem anchored. The June decision to leave the rate unchanged was unanimous, but in their June projections almost all the FOMC members expect that a further rate increase (median 50 bp) will be necessary before the end of this year to achieve 2% inflation. Given the lag in monetary policy transmission, past rate increases affect the economy gradually. The closer inflation returns to the target, the more cautious the interest rate changes must be. Quantitative tightening is continuing according to the previously published plan.

The **BoE** continued to tighten monetary policy in March and May, raising rates by 25 bp in each case. Demand picked up but remains subdued by historical standards. The improved economic outlook reflects stronger global growth, lower energy prices, the fiscal support in the new budget and the possibility that a tight labour market will lead to lower precautionary saving by households. Nominal private sector wage growth and services inflation are still elevated. Headline consumer price inflation started to fall sharply in April, due in part to base effects. The extension of the energy price guarantee and declines in wholesale energy prices are also reflected in the falling inflation. However, food price inflation is falling back more slowly than the BoE previously expected. The BoE judges that the risks around the current inflation forecast are skewed significantly to the upside. In addition, the BoE ended corporate bond sales from its balance sheet in June (see *News*).

I.2 SELECTED INFLATION-TARGETING NON-EU COUNTRIES

	Norway (NB)	Switzerland (SNB)	New Zealand (RBNZ)	Canada (BoC)
Inflation target	2%	0.2%	2%	2%
Publication of MP decisions (rate changes)	23 Mar (+0.25) 4 May (+0.25)	23 Mar (+0.50)	5 Apr (+0.50) 24 May (+0.25)	12 Apr (0.00) 7 Jun (+0.25)
Current basic rate	3.25%	1.50%	5.5%	4.75%
Latest inflation	6.7% (May 2023)	2.6% (Apr 2023)	6.7% (2023 Q1)	4.4% (Apr 2023)
Expected MP decisions	22 Jun 17 Aug	22 Jun	12 Jul 16 Aug	12 Jul 6 Sep



The **NB** increased interest rates by 25 bp at both the March and May meetings. It also announced that the policy rate would most likely be raised further to 3.5% in June. Inflation is still high both in Norway and among its main trading partner countries, although it has started to ease. The Norwegian krone has depreciated in recent months to its weakest level since the onset of the pandemic in spring 2020. It is weaker than the NB projected in March. Economic growth is slowing but remains high. Household consumption continues to increase despite the high inflation and higher interest rates. The labour market is tight and wage growth is higher than last year. The future policy rate path will depend on economic developments. If the krone remains weaker than projected or pressures in the economy persist, a higher policy rate than the NB envisaged earlier may be needed.

The **SNB** tightened its monetary policy further at its March meeting and raised its policy rate by 50 bp. In doing so, it countered the renewed increase in inflationary pressure and the rising inflation, which was due principally to high prices for energy, tourism services and food. The SNB communicated that additional rises in its policy rate may be necessary to ensure price stability over the medium term. Besides changing the policy rate, the SNB is active in the foreign exchange market, selling foreign currency to counter depreciation of the Swiss franc. The SNB tightened its policy despite financial market turmoil following the collapse of US Silicon Valley Bank, after which the second-largest Swiss bank Credit Suisse also got into significant problems (see *News* and the previous issue of CBM). The SNB provided support to Credit Suisse by supplying it with liquidity. The SNB was also involved in the subsequent deal on the takeover of Credit Suisse by the largest Swiss bank UBS.

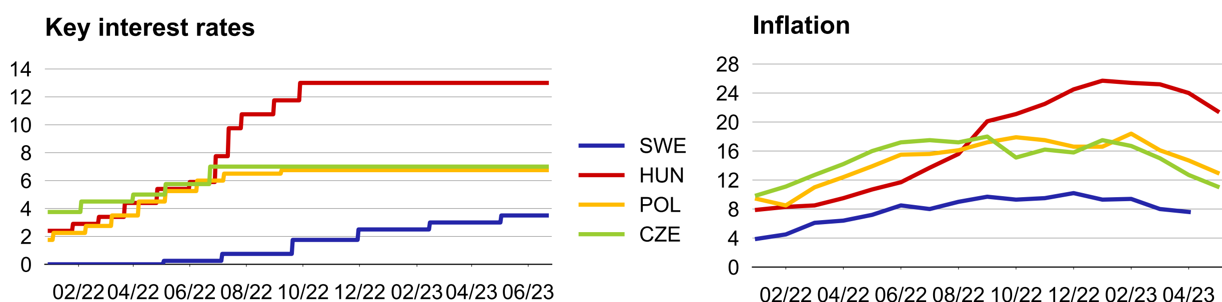
The **RBNZ** continued to tighten monetary policy in April and May, increasing its key rate by 50 bp and 25 bp respectively. The RBNZ announced that the rate would need to remain at a restrictive level for the foreseeable future, to ensure that consumer price inflation returns to the 1–3% annual target range. Although inflation in New Zealand is gradually declining from its peak, core inflation pressures will remain until capacity constraints ease further. While employment is still above its maximum sustainable level, there are now signs of labour shortages easing and vacancies declining. Businesses are reporting slower demand and weak investment intentions. A return of net inward migration since international borders reopened is providing some relief in a very tight labour market. A recovery in tourism and the large-scale repair and rebuild in the North Island, which was devastated by Cyclone Gabrielle in February, are also supporting demand.

After leaving rates unchanged in April, the **BoC** raised them by 25 bp in June and is continuing its policy of quantitative tightening. It reacted, among other things, to new data pointing to surprisingly strong economic growth. Demand for services continued to rebound in Q1. In addition, spending on interest-sensitive goods increased. More recently, housing market activity has picked up. The labour market remains tight despite higher immigration. Overall, excess demand in the economy looks to be more persistent than anticipated. Inflation ticked up in April to 4.4%, the first increase in ten months, with prices for a broad range of goods and services coming in higher than the BoC expected, despite lower energy costs. With excess demand persisting, core inflation has been in the 3.5–4% range for several months. An increase in concerns that inflation could get stuck materially above the 2% target was another reason for tightening monetary policy.

I.3 SELECTED CENTRAL BANKS OF INFLATION-TARGETING EU COUNTRIES

	Sweden (Riksbank)	Hungary (MNB)	Poland (NBP)	Czech Republic (CNB)
Inflation target	2%[1]	3%	2.5%	2%
Publication of MP decisions (rate changes)	26 Apr (+0.50)	28 Mar (0.00) 25 Apr (0.00) 23 May (0.00)	5 Apr (0.00) 10 May (0.00) 6 Jun (0.00)	29 Mar (0.00) 3 May (0.00)
Current basic rate	3.50%	13.00%	6.75%	7.00%
Latest inflation	7.6% (Apr 2023)[2]	21.5% (May 2023)	13.0% (May 2023)[3]	11.1% (May 2023)
Expected MP decisions	29 Jun	20 Jun 25 Jul 29 Aug	6 Jul 6 Sep	21 Jun 3 Aug

Note: [1] CPIF – consumer price index including fixed interest rate; [2] CPIF index; [3] flash estimate.



The **Riksbank** increased its policy rate by a further 50 bp in April. Inflation is still far too high despite having fallen somewhat in recent months. Moreover, the fall in inflation has been driven by energy prices, while inflation disregarding energy prices has been much higher than expected during the first months of the year. The krona has not been a decisive factor behind the substantial rise in inflation, but the central bank feels that a stronger krona would be desirable in this situation. The Riksbank identified the two-year collective wage agreements signed in the labour market as a positive factor in the fight against inflation, creating greater predictability regarding company costs and contributing to reducing the risk of a wage-price spiral. However, the settlement includes a clear expectation that the Riksbank will continue to adjust monetary policy to bring down inflation in the fairly near future, so that real wages can begin to increase again. The Riksbank pointed out that the current forecast indicates that the policy rate will probably be raised slightly further in June or September. However, there is still considerable uncertainty regarding the future, so the assessment of new information will therefore be decisive.

The **MNB** left its base rate unchanged at 13% and announced that it would remain elevated over a prolonged period, ensuring that inflation expectations are anchored to the target. Inflation in Hungary is the highest among the countries under review. According to the MNB's projection, inflation will be 15.0–19.5% in 2023 and return to the tolerance band in 2024. The MNB is currently also using changes to other rates to strengthen monetary policy transmission. An improvement in risk perceptions has enabled it to start normalising rates. It therefore lowered the O/N collateralised lending rate in April and May by a total of 5.5 pp to 19.5%, while leaving the O/N deposit rate at 12.5%. Looking ahead, it plans to further narrow the interest rate corridor. It also reduced the interest paid on optional reserves from 18% to 17% in May.

The **NBP** kept its policy rate at 6.75% at the meetings in April, May and June. The NBP assesses that the weakening of the external economic conditions, together with a decline in commodity prices, will continue to curb global inflation, which will contribute to lower price growth in Poland. This will be supported by a reduction in domestic demand amid a significant decrease in credit growth. Given the strength and persistence of the earlier shocks, however, the return of inflation to the target will be gradual. The decrease in inflation would be faster if supported by appreciation of the zloty consistent with fundamentals. The NBP stated that it may intervene to limit fluctuations of the zloty exchange rate that are inconsistent with the direction of monetary policy.

The **CNB** left its 2W repo rate unchanged at the March and May meetings. Interest rates are at a level that is dampening domestic demand pressures. They are slowing growth in koruna bank loans to households and firms and hence also in the quantity of money in the economy. Strong cost inflation pressures from the external environment and demand pressures from the domestic economy are fading out, and according to the forecast inflation will continue to fall. The still subdued economic activity will gradually return to growth. Taking into account the inflation outlook one year ahead, real interest rates are distinctly positive for the first time in many years. Monetary conditions have been tight in recent months, due partly to the koruna appreciating against the euro. The CNB remains ready to prevent excessive fluctuations of the koruna.

II. NEWS OVER THE LAST THREE MONTHS

Situation in banking sector calms down, Fed reviews collapse of SVB

The banking crisis of March 2023, the major events of which were the collapses of several US banks led by Silicon Valley Bank (SVB) and the fall of Swiss Credit Suisse and its takeover by its competitor UBS (see the last issue of Central Bank Monitoring for more details), has been contained. Even though on 1 May it was announced that another US bank, First Republic Bank, had been closed and sold off to JPMorgan Chase, the impact of the turmoil surrounding these banks on the banking system as a whole was kept under control. In terms of monetary policy implications, the question for the Fed at the time was the extent to which these events would result in an autonomous tightening of monetary conditions through tighter bank lending conditions, which could reduce the need for further interest rate hikes.

The Fed also approved the takeover of Credit Suisse's US subsidiaries by UBS in April. In addition, the Fed, under the leadership of its Vice Chair for Supervision Michael S. Barr, analysed the causes of SVB's collapse and the role of supervision and regulation. According to the results of this analysis, SVB's board of directors and management failed to manage interest rate and liquidity risks. However, the Fed also acknowledges mistakes of its own – its supervisors did not fully appreciate the extent of the vulnerabilities as SVB grew in size and complexity. Where the Fed's supervisors did identify vulnerabilities, they did not take sufficient steps to ensure that SVB fixed those problems quickly enough. A negative role was also played by a law passed in 2018 that eased regulation of the banking sector and, among other things, raised the threshold for the size of banks' balance sheets at which banks were subject to stricter regulatory rules. Due to the increase in the threshold, the stricter rules did not apply to SVB. In the wake of the banking crisis and the findings of this analysis of it, the Fed will continue to work to strengthen its regulatory and supervisory framework.

Dollar liquidity operations expanded during banking crisis have been reduced

In reaction to the turmoil in the banking sector in March, the major central banks agreed with the Fed to conduct daily operations under the dollar liquidity swap line arrangements in order to enhance the provision of dollar liquidity (see the last issue of CBM). Given the subsequent calming of the situation and the low demand for these operations, however, the ECB, the BoJ, the BoE and the SNB later issued a statement announcing that, in consultation with the Fed, they had jointly decided to revert the frequency of these operations to weekly starting in May.

New Turkish central bank governor

The re-elected Turkish president Recep Tayyip Erdogan appointed a new governor of the Turkish central bank, Hafize Gaye Erkan. Her previous experience includes stints at US investment bank Goldman Sachs and also at the recently failed First Republic Bank. The previous governor, Sahap Kavcioglu, who, despite galloping inflation, had cut interest rates during his tenure in line with President Erdogan's stance, has moved to head the office that regulates and supervises the banking sector. Now the question is whether the change in the leadership of the central bank will lead to an adjustment of Turkish monetary policy in a situation of still very high inflation and record weakness of the lira exchange rate, or whether the Turkish president's very unorthodox monetary policy views will continue to prevail.

BoE concludes corporate bond sales under quantitative tightening

In June, the Bank of England announced that it had sold off a significant majority of the corporate bonds it had previously bought under the Asset Purchase Facility (APF). The bank has only retained bonds representing less than 5% of the original corporate bond portfolio. These remaining bonds have a very short maturity (April next year at the latest) and the bank no longer plans to sell them but intends to hold them to maturity. In the past, as part of quantitative easing, the BoE mainly purchased government bonds, but to a lesser extent it bought corporate bonds as well, of which it held GBP 20 billion out of the total GBP 895 billion of assets bought under the APF when the purchases were completed. In February last year, the BoE decided to sell its corporate bonds, and these sales subsequently occurred from September 2022 to June 2023. The BoE is continuing the process of selling government bonds from the APF portfolio (ongoing since last November).

Results of RBA's external review published, BoJ and BoE announce reviews

A wide-ranging review of the RBA's monetary policy, also covering its operation, governance and institutional set-up, has been going on since the summer of last year. The results of this external review and its recommendations are summarised in a report published in April.

In April, the Bank of Japan held its first monetary policy meeting under the leadership of its new governor Kazuo Ueda. At the meeting, the BoJ kept its instruments unchanged but adjusted its forward guidance and announced its intention to review its monetary policy. In June, news emerged that the Bank of England also plans to arrange a review of its forecasting processes. We discuss the monetary policy reviews of the RBA, the BoJ and the BoE (and also of the New Zealand RBNZ) in more detail in *Spotlight* in this issue.

III. SPOTLIGHT: MONETARY POLICY REVIEWS IN THE LAST YEAR

Assessing the functioning of the monetary policy regime and its parameters is an essential element of monetary policy-making. Some central banks do so on an ongoing basis, while others carry out formalised monetary policy reviews. A comprehensive monetary policy review has recently been conducted at the Australian RBA. The results were published this April. The review's recommendations will be implemented in the coming months, depending partly on the RBA's decisions and partly on legislative changes. New Zealand's RBNZ conducted a review of its monetary policy over the period 2017–2022 and is preparing advice for the Minister of Finance regarding its mandate. Japan's BoJ and the UK's BoE are also expected to review monetary policy in the near future.

Central banks must respond to a changing economic environment and the latest economic research in their work. While some central banks analyse and, where necessary, modify their monetary policy strategies on an ongoing basis, others opt for wide-ranging monetary policy reviews. A review can take various forms – depending on the institutional set-up and legislation in the given country, it may be initiated by the central bank itself, the government or parliament; it can be prepared internally by the central bank's analysts or externally by hired experts (usually including international ones) or a combination of the two, i.e. internally with external consultations; it can be conducted regularly every few years or ad hoc in response to specific events. Reviews may also differ in their depth of scope (for example an analysis of specific parameters of a monetary policy regime versus a comprehensive assessment of the entire monetary policy framework, including decision-making processes and the institutional set-up). In any event, a review is a formalised process enabling a monetary policy strategy, or individual parts thereof, to be assessed transparently and changed where appropriate (however, we should note that past monetary policy reviews have not usually led to major changes but only to non-binding recommendations or small monetary policy adjustments).

The above general aspects of monetary policy reviews were described in more detail in *Spotlight* in Central Bank Monitoring – March 2020, which also contained a detailed overview of the reviews conducted in the past in the central banks we monitor.[1] In this article we focus on the reviews performed in the last year and on those that are currently under way or have been announced – specifically at Australia's RBA, New Zealand's RBNZ, Japan's BoJ and the UK's BoE.

An extensive review at the Australian central bank

The RBA's monetary policy underwent a wide-ranging review between July 2022 and April 2023. This was the first such large review conducted at the RBA, at least since inflation targeting was introduced in the 1990s. The review was announced in response to developments in recent years. The RBA introduced forward guidance during the Covid pandemic, when it declared that interest rates would be likely to stay close to zero at least until 2024. Although this forward guidance was largely conditional on the economic situation, the RBA did not succeed too well in distinguishing between the expected future developments and an explicit commitment in its communications. It was ultimately forced to reconsider its position due to mounting inflation pressures, and it started to raise its interest rates in May 2022 (the key rate has gradually increased by 4 pp from an initial 0.10% to the current 4.1%). Although its rate hikes were smaller than those of other central banks, the high proportion of floating-rate loans meant that the start of the rate-raising cycle quickly affected many Australians, who had additionally relied on the central bank's above-mentioned communications that it would keep interest rates low (RBA Governor Philip Lowe later publicly apologised for the previous pledge). The central bank thus came under serious criticism from the public due to the unexpected start of interest rate increases. On the other hand, it was criticised for responding late and postponing interest rate hikes in the face of rising inflation. These events led the Treasury to announce an extensive external ad-hoc review of the RBA's monetary policy in July 2022.[2]

The review was assigned to a three-member panel of domestic and foreign experts.[3] It covered a wide range of topics, from the bank's objectives, through policy implementation, governance processes and public communications, to the relationship between monetary, macroprudential and fiscal policy settings. The review also involved several rounds of talks between the expert panel and the central bank, inputs in the form of papers from other external experts, surveys among

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[1] In addition, the results of the monetary policy reviews conducted by the Fed and the ECB in recent years have been the topics of selected speeches in Central Bank Monitoring in September 2020 (Jerome Powell – Fed review) and September 2021 (Isabel Schnabel – ECB review).

[2] The RBA last year internally prepared its own assessment of the unconventional tools it used after the outbreak of the Covid pandemic: yield curve targeting, asset purchases and forward guidance. It generally evaluated these tools as having worked as intended in the first phase of the pandemic but later causing problems. The RBA says that these instruments may be used again, but only in extreme circumstances. For more details on the assessment of these tools, see *News* in last year's September and December issues of Central Bank Monitoring.

[3] The panel members were Carolyn Wilkins, a former Bank of Canada deputy governor and a current member of the Bank of England's Financial Policy Committee, Australian professor of macroeconomics Renee Fry-McKibbin, and Gordon de Brouwer, who has extensive experience in senior posts in Australian public administration.

current and former RBA staff members and a public consultation in which the public and interest groups could make suggestions and comments on the RBA's activities. The results of the review are summarised in a detailed report published in April 2023. The reasons for the review, along with its course and results, are described on a website available here.

The review endorsed the main elements of the RBA's current monetary policy framework based on flexible inflation targeting with a target band of 2–3%, but recommended greater clarity in the framework. The RBA should aim to keep inflation at the midpoint of the target band and drop the phrase "on average, over time" from the wording of the target, as it is vague and difficult to interpret. It should also clearly define its dual mandate of price stability and full employment (the monetary policy objectives are currently defined more broadly as (1) stability of the currency of Australia, (2) full employment, and 3) the economic prosperity and welfare of the people of Australia; however, the review recommends that the RBA redefine the first objective as price stability and remove the third one, as the latter is not a separate objective of monetary policy but an overarching purpose for the RBA, which the bank can attain by ensuring price stability and full employment). The review also recommends further enhancing the RBA's monetary policy independence.

One important recommendation is a change to the RBA's governance arrangements. At present, the RBA's governing and monetary policy decision-making body is the Reserve Bank Board, which comprises the Governor, Deputy Governor, Treasury Secretary and six external members. According to the authors of the review, the bank's governance is thus heavily concentrated in the hands of the Governor and Deputy Governor. At the same time, the external members are in some cases people who, despite being experts in their fields, have education and previous experience in areas other than economics and finance and lack expertise in monetary policy. The review therefore recommends dividing the Board into two new boards – a Governance Board responsible for the management of the institution, organisational strategy, staff planning, finances and so on (although with an oversight rather than executive role) and a Monetary Policy Board responsible for monetary policy and (under the RBA's limited mandate in this area) financial stability. The Governor should be a member of both (but should not chair the Governance Board, which should be headed by one of the external members). The review proposes no changes to the organisation of the Monetary Policy Board itself, i.e. its nine members, including the Treasury Secretary and six external members. However, these external members should have sufficient expertise in areas relevant to monetary policy.

Other recommendations of the review include reducing the number of monetary policy meetings from 11 to 8 to allow time for deeper analyses and discussions. To increase transparency, the Governor should also hold regular press conferences after each monetary policy meeting. Moreover, the amount of monetary policy information available about monetary policy deliberations, the bank's forecasts and in general the reasoning behind decisions should increase, and the Board members should be more active in engaging with the media and their differing views should be communicated more. Detailed documents on monetary policy decision-making should be published after five years.

The authors of the monetary policy review also advocate further developing the RBA's forecasting tools, especially around the supply side of the economy and fiscal policy. The central bank should take account of climate risks but not use monetary policy to address them, as other public policies, for which elected representatives should be responsible, are better suited to this. The RBA's financial stability mandate should be better defined, as the central bank has an important role in this area (through providing liquidity, for example). This role, however, does not have a sufficient legislative basis at present.[4] The RBA is also recommended to conduct regular reviews every five years, with input from external experts.

Some of the recommendations can be implemented at the discretion of the RBA, while others would require changes to legislation and are thus subject to legislative processes. RBA Governor Lowe commented broadly positively on the review. He welcomed its support for the central bank's existing monetary policy regime and independence, and many of its recommendations. Yet he expressed some reservations about how the final report describes the Reserve Bank Board's current workings and decision-making. The central bank is expected to publish a more detailed response to the review later this year.

Review of past monetary policy and advice on the mandate of the Reserve Bank of New Zealand

While the RBA review was prepared at the decision of the Treasury, a more formalised approach is taken in New Zealand. The RBNZ works on two related processes with a five-year frequency. The first is a review of its monetary policy over the previous five years, including the identification of areas in which there is room for improving previous practice. The second process is related to the Monetary Policy Committee's remit, a document specifying the main elements and objectives of the RBNZ's monetary policy regime (including, for example, its inflation target). The minister of finance is responsible for

[4] The RBA does not have a legislative mandate to ensure financial stability. That mandate, including relevant tools in the form of capital buffer requirements and lending constraints, lies with the Australian Prudential Regulation Authority.

issuing this remit and hence also for defining the central bank's mandate. However, the RBNZ has a legal obligation to advise the minister at least every five years on whether the remit should be replaced, amended or remain in force.

Although the two review processes mentioned above are to be conducted every five years, this is the first time they have taken place in this format, since the current system was only introduced around five years ago. A review of monetary policy in 2017–2022 was published in November 2022, while the updated MPC remit has not yet been completed. The RBNZ mostly conducts the two processes internally but with external input. Two independent experts provided comments on and published opinions of the review of monetary policy in previous years. Two rounds of public consultations were then held as part of the preparation of the advice on the MPC's remit.

According to the review of monetary policy 2017–2022, monetary policy was slightly tighter in the pre-pandemic years than assumed over this period, since the neutral interest rate was revised down in retrospect. This may have contributed to the undershooting of the inflation target in this period. After the outbreak of the pandemic, the RBNZ lowered the interest rate to 0.25% and also implemented unconventional monetary policy instruments (asset purchases, forward guidance and the Funding for Lending Programme). These instruments were effective at restoring functioning to the financial system during the pandemic and helped avoid the worst-case scenario of a deep recession. On the other hand, in hindsight, monetary policy could have been tightened earlier in 2021 (both by ending the use of unconventional tools and by starting to raise interest rates) in response to rising inflation pressures (interest rates were eventually raised for the first time in October 2021). However, beginning the monetary policy tightening earlier would not have fully offset the strong inflation impulse stemming from Russia's invasion of Ukraine and the various climate-related supply shocks. The review of monetary policy in previous years also led to the identification of several areas for further development, including more detailed analysis of the impacts of supply shocks on inflation, increased use of high-frequency data, better measures of neutral interest rates and refinements to the measure of "maximum sustainable employment".

The RBNZ is required to provide its advice on the MPC's remit by November this year, but work on preparing the advice has been ongoing since 2021. A first round of public consultation took place in summer 2022 and a second in late 2022 and early 2023.[5] In 2022, the RBNZ published an interim report containing preliminary positions on key areas of the central bank's mandate as part of its communication with the minister of finance and its efforts to jointly define the review topics. According to the report, the current flexible inflation targeting regime with its 2% target (1–3% target band) remains the best choice for monetary policy. CPI inflation should remain the target measure. In preparing its advice on the MPC's remit, the RBNZ also announced its intention address the issue of introducing a clear hierarchy of objectives (as distinct from a dual mandate of price stability and maximum sustainable employment) and the issue of whether the central bank should explicitly consider the effect of monetary policy on house price sustainability, which became part of its mandate in 2021.

As part of the second round of public consultation, the public also had the opportunity to express an opinion on the second document important for the RBNZ's monetary policy, the MPC charter. Unlike the MPC remit, this is the result of an agreement between the RBNZ and the Ministry of Finance and covers the central bank's decision-making processes, transparency and communication. In the above-mentioned interim report, the RBNZ advised that it will, among other things, also explore its current consensus-building decision-making model alongside alternative models.

The recently announced review of the BoJ's monetary policy and the review of the BoE's forecasting processes

In April 2023, Kazuo Ueda replaced Haruhiko Kuroda as Governor of the Bank of Japan. At the first monetary policy meeting chaired by the new governor, the BoJ left its instrument settings unchanged. However, in his announcement, Governor Ueda omitted the sentence that he expects interest rates to remain at current or lower levels. In addition, the BoJ has decided to conduct a broad-perspective review of monetary policy. The context of the review is that achieving price stability has been a significant challenge over the past 25 years due to deflationary pressures, which the BoJ has tried to address with a series of expansionary instruments and measures, the effects of which will be analysed in detail in the review. The planned time frame for the review is one to one and a half years.

The Bank of England has also just announced a review. The BoE's management[6] commissioned the review in May but did not announce it until mid-June, in a letter addressed to the Chair of the Treasury Committee. The review is expected to be narrower in scope than the ones discussed above – it is to focus on forecasting and related processes during times of significant uncertainty. The context of the review is the BoE's previous failure to capture rising inflation pressures in its modelling system, and the resulting public criticism and reduced role of model-based forecasts in the decision-making of

[5] Detailed information on the MPC remit review, including papers relating to both rounds of public consultation, can be found on the RBNZ website.

[6] The decision to commission the review was made by the Court of Directors, which is the body responsible for setting the bank's overall organisational strategy and budget. The review is thus not the result of a decision made by the Monetary Policy Committee (although the Governor and three Deputy Governors are members of both these BoE bodies).

the members of the Monetary Policy Committee. The review is to be led externally, supported by the BoE’s internal supervisory unit, the Independent Evaluation Office. Further details about the review have yet to be disclosed.

Conclusion

Given the constantly evolving economic situation and advances in economic research, central banks need to assess the appropriateness of their monetary policy regimes and their parameters and related processes. Some central banks do this on an ongoing basis, while others opt for a formalised monetary policy review (or, depending on the institutional relationship between the central bank and the government in the country concerned, the review is the result of a government decision or a legal obligation).

The results of a wide-ranging external review of the Australian RBA were published in April 2023. The implementation of the recommendations of the review depends partly on the decisions of the central bank and partly on legislative changes. Which of the recommendations will actually be implemented in practice is something that will be decided on in the coming months. New Zealand’s RBNZ last year published a review of its monetary policy over the period 2017–2022 and is preparing advice for the minister of finance on possible changes to its mandate. It is required to submit this advice by November 2023 (although it can be expected to do so slightly earlier). Both of these processes are governed by law and the central bank must conduct them every five years. In April 2023, the BoJ announced it was preparing a monetary policy review. The results can be expected to be published in around one to one and a half years. In mid-June, news emerged that the BoE also intends to arrange an external review of its forecasting processes.

IV. SELECTED SPEECH: Christine Lagarde: Central banks in a fragmenting world

Christine Lagarde, President of the European Central Bank, in her April speech at the Council of Foreign Relations, talks about the fragmentation of the global economy into competing blocs and its effect on the policy environment for central banks.

The global economy has been undergoing a transformative change. Following the pandemic and Russia's war against Ukraine, as well as a growing rivalry between the United States and China, the tectonic plates of geopolitics are shifting faster. According to Lagarde, we are witnessing a fragmentation of the global economy into competing blocs, with each bloc trying to pull as much of the rest of the world closer to its respective strategic interests and shared values. All this could have far-reaching implications across many domains of policymaking.

A changing global economy

After the Cold War, the world benefited from a remarkably favourable geopolitical environment. Under the leadership of the United States, rules-based international institutions flourished and global trade expanded. As a result, global supply became more elastic to changes in domestic demand, leading to a period of low and stable inflation. However, that period of relative stability may now be giving way to one of lasting instability resulting in lower growth, higher costs and uncertain trade partnerships. Instead of more elastic global supply, we could face the risk of repeated supply shocks. Lagarde claims that disruptions to supplies of materials such as minerals could affect critical sectors in the economy. In response, governments are legislating to increase supply security, but that could in turn accelerate fragmentation. Indeed, in the wake of the Russian invasion of Ukraine, the share of global firms planning to regionalise their supply chain almost doubled compared with a year earlier. This "new global map" – as Lagarde has called these changes – is likely to have implications for central banks. Data since 1900 show that heightened geopolitical risks led to high inflation, lower economic activity and a fall in international trade. An ECB analysis suggests similar outcomes can be expected for the future.

A second shift in the central bank landscape is also taking place – we may see the world becoming more multipolar. After 1945, the US dollar asserted itself as the global reserve and transaction currency, and more recently, the euro has risen to second place. According to Lagarde, this had mostly beneficial implications for central banks. In parallel, Western payments infrastructures assumed an increasingly global role. However, new trade patterns may have ramifications for international payments and currency reserves. In recent decades China has increased over 130-fold its bilateral trade with developing economies, becoming the world's top exporter. Recent research indicates there is a significant correlation between a country's trade with China and its holdings of renminbi as reserves. All this could create an opportunity for countries seeking to reduce their dependence on Western payment systems and currency frameworks.

Policy frameworks for a fragmenting world

The ECB president notes that we have clear examples of what not to do when faced with a sudden increase in volatility. In the 1970s, central banks failed to provide an anchor of monetary stability and inflation expectations de-anchored – a mistake that should never be repeated for as long as central banks are independent and have clear price stability mandates. If faced with persistent supply shocks, independent central banks can and will ensure price stability. Still, this can be achieved at a lower cost if other policies (fiscal, structural,…) are cooperative and help replenish supply capacity. Insofar as geopolitics leads to a fragmentation of the global economy into competing blocs, this calls for greater policy cohesion. Not compromising independence, but recognising interdependence between policies, and how each can best achieve their objective if aligned behind an overall strategic goal.

According to Lagarde, achieving the right policy framework will determine not only how our economies fare at home, but also how they are viewed globally in a context of greater "system competition". An economic policy mix that produces less volatile growth and inflation will be key in continuing to attract international investment. For Europe, long-delayed projects such as deepening and integrating capital markets can no longer be viewed solely through the lens of domestic financial policy. The EU needs to complete the European capital markets union. This will be pivotal in determining whether the euro remains among the leading global currencies. Central banks also have an important role to play here. For example, the manner in which swap lines are used could influence the dynamics of major global currencies. Both the Federal Reserve and the ECB, within their respective mandates, have been proactive in providing offshore liquidity when recent crises have hit. However, other central banks are moving too, which is consistent with a rising role of their currencies.

Lagarde concludes her speech by accenting that policymakers need to be ready for the new reality that may well lie ahead. The time to think about how to respond to changing geopolitics is not when fragmentation is upon us, but before. Central banks must provide for stability in an age that is anything but stable.

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