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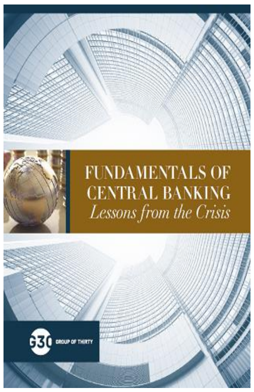
The Central Bank of Barbados Book Review Series seek to highlight publications which offer useful insights and analysis on topics related to finance, economic development, and other issues relevant to small island developing economies. The views expressed are those of the author(s) and do not necessarily represent those of the Central Bank of Barbados.



FUNDAMENTALS OF CENTRAL BANKING: LESSONS FROM THE CRISIS

Authors: G30 Working Group
Publisher: Group of Thirty, Washington, D.C. (October 12, 2015)

ISBN: 1-56708-167-3

Book Review contributed by DeLisle Worrell.

This book is notable for the fact that its authors are an unparalleled group of outstanding global financial officials and experts. The list includes seven Governors, Presidents or Chairmen of central banks or monetary authorities, a distinguished former Chief Economist of the IMF, leading academics, and CEOs and other top managers of financial institutions with a global reach.

The report notes that central banks in advanced market economies reacted vigorously to tackle the 2007/8 financial crisis, and to restore financial stability. They mention the measures taken: reducing policy interest rates to zero, using forward guidance, central bank purchases of large amounts of securities to supply liquidity, and intervention to avoid the collapse of large financial firms. These efforts were crucial in restoring financial stability.

The lessons the Group draws from this experience are that the key pillars of central banking should be maintained: price stability is "most important", financial stability should be an important part of the mandate, and the independence of the central bank should be maintained. About the only innovation they contemplate is the use of so-called "macroprudential policies", such as the stipulation of minimum equity requirements for credit. In fact, these policies are not new; the reason they have not been in widespread use hitherto is that their efficacy is very questionable, and that remains the case. The fact that leading thinkers are now advocating such dubious policy suggests that there is nothing effective in their toolkit.

In truth, what the Group refer to as the "key pillars that constitute the foundations of central banking" have not been definitively established from an analytical point of view, though they have been accepted by most central banks, Barbados being a conspicuous exception. To illustrate, consider two of the report's strong recommendations: that price stability should be the central bank's principal objective, and that flexible exchange rates are the best way to minimise the international repercussions of monetary policies. In today's world where all financial markets are open, exchange rate changes are driven by financial flows, and the exchange rate loses its power as a shock absorber. At the same time, depreciating exchange rates are inflationary for oil importers and small economies, so their best bet for dampening inflation is to target the exchange rate, as Barbados does. The foundation for this key pillar is unsound.

The lessons for central banking from the recent crisis are unclear, but they are more far reaching than the Group of Thirty report suggests. To gain in depth insight into some of these issues, see Avinash Persaud's recently published book, *Reinventing Financial Regulation*.