"Revisiting the last decade of monetary policy"

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The last decade has tested our monetary policy frameworks through the extremes of both stubbornly low inflation and unanticipated high inflation. All this has been against the backdrop of rapid financial, economic and geopolitical changes that manifestly complicate the calibration of appropriate policy. Reflecting on this experience, I would like to highlight **one lesson and one conundrum.**

First, the lesson. With so much uncertainty encountered over the past decade, I cannot understate **the importance of a robust monetary policy framework.** This consists of at least three key elements.

The first essential element is to **put a premium on stability.** In the face of noisy economic signals, policy *itself* should not be an additional source of uncertainty. This can be achieved by erring on the side of stability and **not overreacting to the latest data.** Data can be noisy; thus policy should aim to be "outlook-dependent" as opposed to "data-dependent". In essence, this is the signal extraction problem for policy. For example, given that inflation comprises a myriad of relative price changes, the challenge is how to look through transitory price changes and focus on the persistent underlying price trend. A related point is to **avoid excessive fine-tuning.** Events of the past decade have highlighted the need for us to remain humble and to not overestimate our ability to influence or affect key variables. During the recent high-inflation episode, we have seen that inflation is subject to very large relative price changes that are completely outside of our control.

The second element is to **preserve optionality**. Given the amount of uncertainty we face, it is important to avoid being caught out and forced to reverse course. In setting policy, rather than aiming for what is optimal, it may be better to aim for a policy setting that is robust to a wide range of outcomes. This means not tying yourself down or doing things that unnecessarily constrain your room to manoeuvre, such as through excessive forward guidance – at least the kind that suggests some sort of predetermined policy path. Finally, having multiple buffers such as well capitalized banks, foreign exchange (FX) reserves and policy space is also key to preserving optionality and enhancing the robustness of the monetary policy framework.

A third key element is to **utilize complementary policy tools**. Using a macro-financial stability or integrated policy framework has helped improve policy trade-offs and afforded monetary policy more degrees of freedom. For many small open economies, including Thailand, judicious use of FX intervention has been quite important in smoothing out excessive volatility. At the same time, macroprudential tools can help constrain excessive build-up of financial imbalances, while financial measures more broadly can help cushion fragile groups. That said, while we have a good toolkit for monetary policy, such as Taylor rules and r-stars (the real natural rate of interest), the analytical toolkit to support complementary policy tools like FX intervention or even macro-prudential measures is lacking. Right now, we do not have the equivalent of a “credit-to-GDP star” to guide policy decisions. This highlights the need for a better analytical toolkit to guide us in operationalizing the macro-financial stability framework.

Now let me turn to the conundrum. If we take a step back and look over the past few decades, there is little doubt that monetary policy overall, and inflation targeting in particular, has been a clear success. By any metric, be it reduced output volatility, lower levels of average inflation or a reduced number of episodes of banking and financial stresses, **monetary policy has delivered.** For emerging market economies in particular, credible policy frameworks – most importantly central bank independence (CBI) – have been *the* key reason for the remarkable resilience that they have shown over the last few years in the face of surging world interest rates.

Yet, currently, central banks seem to be under pressure more than at any time over the last decade. Central bank independence in many countries, including Thailand, is being challenged despite having done a reasonable job over past decades. As such, **it seems that while delivering on our mandates is a necessary condition for maintaining independence, it is not a sufficient one.** Why is this the case? While I do not have a clear answer, allow me to offer three thoughts.

First, there seems to be **a disconnect between central banks’ key performance indicators (KPIs) and the public’s KPIs.** Monetary policy focuses on broad aggregates or average figures that may not necessarily resonate with the public because these figures mask heterogeneity across sectors, firms and households. Therefore, while broad aggregates may appear fine as a whole, they may not be that way for a lot of people. It is a case of *my* GDP vs *your* GDP, *my* shopping basket vs *your* shopping basket. Also, our **policy horizon is a medium-term one**, whereas firms and households may focus more on the short term, as they live in real time. Importantly, the disconnect can also arise because **much of what we do is to prevent bad things from happening**. Successful policy prevents much worse outcomes such as runaway inflation or a banking crisis. But in doing so successfully, the public never experiences that gain but only the pain. They taste only the bitter medicine and not the disease. It is hard to motivate policy in a compelling way by referring to a counterfactual.

All this is *inherent* in the nature of our policy and is thus nothing new. The question then is why has the discontent become more intense lately? This brings me to the second factor. Over the last decade **there has undoubtedly been dramatic changes in the nature and method of public discourse**. Over time, information flow and public debate has moved from a largely centralized model – through traditional mass media (television, radio, newspapers) – to increasingly decentralized ones (social media, online platforms). With greater fragmentation and competition for attention, alternative narratives and polarisation arise more easily through virtual echo chambers. It has become more challenging to get the message through.

Finally, over the last decade central banks have been through a lot. Unconventional policies, expanding balance sheets and pervasive crisis measures **have expanded central banks' footprints in private markets**. This raises peoples' expectations on what a central bank can achieve, and it results in not just moving the goalpost but also adding more goalposts. As expectations increase, it becomes harder to ring-fence our reputation, credibility and the case for central bank independence.

Whatever the reason for the divergence in performance and perceptions, we need to understand and address it because if we allow CBI to be eroded, then we will not be able to deliver on our core mandates. Here let me note that even as the focus of CBI is mostly in regard to monetary policy, the fact is that **CBI hinges just as much on how central banks perform in other areas**, notably banking supervision. Much of the underlying source of pressure on central banks arises from perceived shortcomings in the banking sector – be they high fees, financial access, excess profits or bank failures. Therefore, for my closing point, let me leave us with some food for thought for the future – **doing monetary policy well requires doing central banking well.**