Are Central Banks Losing Their Big Bet?

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Following the 2008 global financial crisis, central banks bet that greater activism on the part of other policymakers would be their salvation, helping them to normalize their operations. But that activism never came, and central bankers are now facing a lose-lose proposition.

ZURICH – In recent years, central banks have made a large policy wager. They bet that the protracted use of unconventional and experimental measures would provide an effective bridge to more comprehensive measures that would generate high inclusive growth and minimize the risk of financial instability. But central banks have repeatedly had to double down, in the process becoming increasingly aware of the growing risks to their credibility, effectiveness, and political autonomy. Ironically, central bankers may now get a response from other policymaking entities, which, instead of helping to normalize their operations, would make their task a lot tougher.

Let's start with the US Federal Reserve, the world's most powerful central bank, whose actions strongly influence other central banks. Having succeeded after 2008 in stabilizing a dysfunctional financial system that had threatened to tip the world into a multiyear depression, the Fed was hoping to begin normalizing its policy stance as early as the summer of 2010. But an increasingly polarized Congress, exemplified by the rise of the Tea Party, precluded the necessary handoff to fiscal policy and structural reforms.

Instead, the Fed pivoted to using experimental measures to buy time for the US economy until the political environment became more constructive for pro-growth policies. Interest rates were floored at zero, and the Fed expanded its non-commercial involvement in financial markets, buying a record amount of bonds through its quantitative-easing (QE) programs.

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