

Do's and Don'ts in Central Bank Design

Rethinking the Central Bank's Mandate

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Practical “don’ts” for central banks

- Don’t set up ‘narrow’ operating frameworks – for monetary policy implementation or liquidity provision
 - Don’t create new facilities (LoLR) over the weekend.
 - Don’t make the collateral framework a moving target
- Don’t insist ‘we will never do X’, if X is (legally) allowed.
- Don’t assume a bright line between central bank lender-of-last-resort and the solvency/resolution mechanism.
 - Don’t try to determine solvency over the weekend.
 - Don’t treat solvency risk assessment as static
- Don’t neglect the plumbing

Practical “do’s” for central banks (& others)

- Do design lender of last resort facilities, collateral rules and capacity for systemic, not idiosyncratic events
- Do regularly analyze policy transmission mechanisms and how they can/will break
- Do crisis management planning – regularly
- Do clarify *decision-making* on fiscal vs. monetary policy
 - Solvency
 - Resolution
 - Liquidity/credit provision
- Do maintain responsibility and authority over the plumbing

Lessons for central banks on financial stability

- Lender of last resort and balance sheet (credit) policy are
 - a. financial stability policies
 - b. fiscal actions with political consequences
- Monetary policy ‘independence’ is tempered by fiscal implications of central bank responsibilities
- Constructive ambiguity on central bank powers and perimeter of regulation/safety net *increases* moral hazard
- Regulatory arbitrage, lapses and gaps *become the central bank’s problem* even if it has no regulatory responsibilities.
- Financial stability role is global; political consequences are local

Implications for central bank design

- Central banks are in the financial stability business
 - Lender of last resort, liquidity/credit
 - Balance sheet composition
- Clean-up or prevention?
 - Dependencies: solvency determination, system-wide regulatory authority, resolution authority, regulatory coordination and information sharing
 - Responsibility with or without authority?
 - Will committees or split responsibilities work in practice or end up as constructive ambiguity?
- Cross-border dependencies