

Does a Central Bank Seek “Credibility—Or a Balance of “Dis-credibility”?

In monetary-policy circles, hardly a day passes without somebody somewhere declaring, sometimes in the form of a florid proclamation, that a central bank must have “credibility.”

Otherwise, it is ominously posited, we slide soon into the Weimar Republic, although some later variants suggest the modern-day Japan scenario. That is, no one trusts the central bank to inflate enough.

If this version of monetary policy is true, then at the end of the day the long-faced serious monetary-policy community slides into bed and embraces (this is the G-rated version) the much-ridiculed behavioral economists.

An economy will or will not have inflation because of what people feel and believe about a central bank. Hand out the mood rings.

What is “Credibility”

Back in 2014, the Pew Research people asked Americans who was the Federal Reserve Chair—and gave a cheat-sheet. One of four names was provided. The research outfit then reported, “Just 24% of Americans correctly pick out Yellen ...as the chair of the Federal Reserve Board. Nearly one-in-five (17%) say the

current head of
the Fed is Alan Greenspan, who led the board from 1987 to 2006.
About
one-in-ten chose a Supreme Court justice, either Sonia Sotomayor
(6%) or John
Roberts (5%). And roughly half (48%) did not offer a guess.”

If there are polls that more deeply explore
the public’s knowledge of the Federal Reserve’s arcane policies and
machinery,
they do not appear to be online.

Elites

Of course, it might be posited that among
financial elites, most responsible actors understand the Federal
Reserve Board.
(One could quibble with this, since even among monetary-policy
academics there
are evidently permanent disputes about what it is the Fed really
does, when,
say, it conducts QE, or applies IOER, or conducts a few hundred
billion in
“re-po’s.” But let’s allow that financial elites understand the
basics).

And among financial elites, at least as
represented in the financial media, there is at any moment a large
contingent
who argue to the Fed is “blowing asset bubbles,” or engaging in
“financial
repression” or in some other manner drugging and whipping the
financial
thoroughbred ahead for a few more strides before inevitable
collapse on the
track. I think it is safe to say, that with this segment of the
knowledgeable

financial elite, the Fed has no credibility.

Credibility

Yet, inflation has been tame for decades in the US. Inflation has been and below unofficial and then official targets for decades in Japan, and now below target in Europe and China.

Given that a large fraction of even Fed-junkies will ever be in opposition to the Fed, and hold the Fed in disregard, what is the “credibility” that the central bank seeks? It appears the Fed does not have credibility, perhaps among a plurality of intelligent observers.

Then, is what the Fed seeks not credibility but rather a “balance of dis-credibility”?

That is, about half of the financial elite think the Fed is “too tight” and half think it is “too loose”?

Conclusion

It is a bit disconcerting that after all the graphs, the well-reasoned arguments, the tomes, that monetary policy (say many experts) boils down to the indefinable “credibility” of a central bank.

Actually, I doubt it. Surely, the vast majority of participants in an economy are price-takers and do not ponder the

Fed. They sell for what the market will bear. They could sit through a 10-hour lecture that the Fed is "tightening up," then go back to their hot-dog stand, and if there is a long line, raise their prices.

I suspect the Fed is in the business of managing real aggregate demand, but has been loath to do it!

You could say my view is 'incredible.'
