

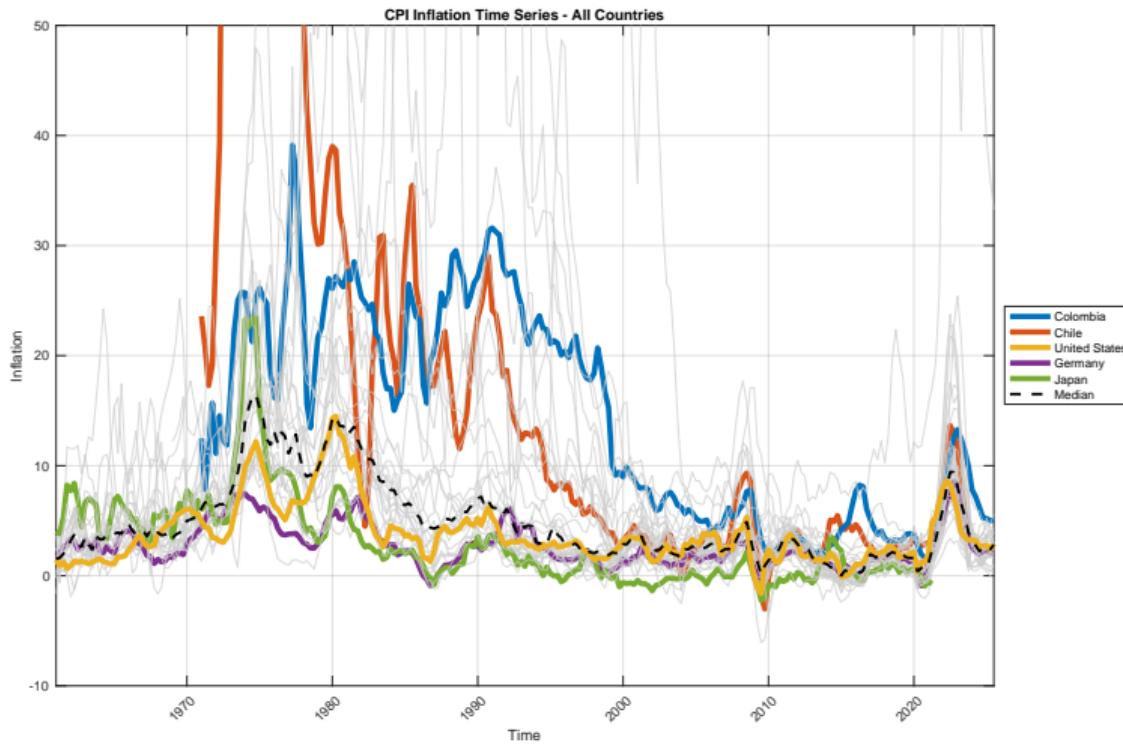
Evidence on independence: Why is it useful? How does it work?

Francesco Bianchi

Johns Hopkins University
NBER & CEPR

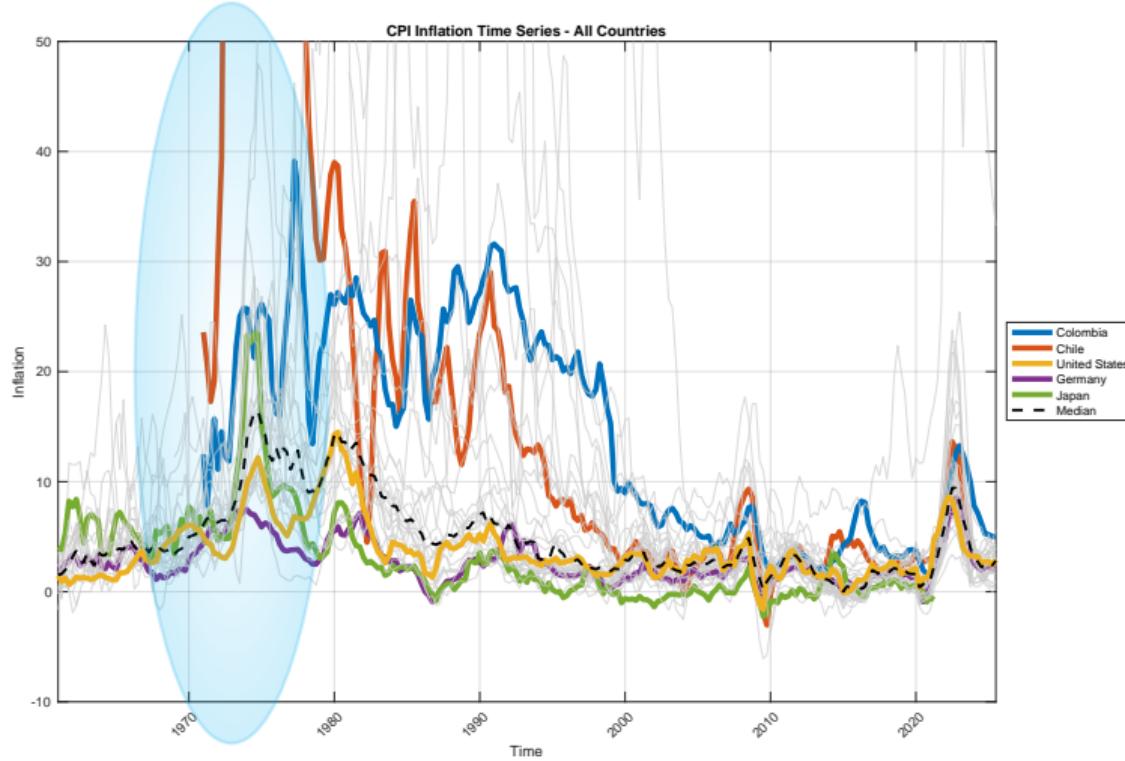
Inflation across space and time

- Why is central bank independence important?



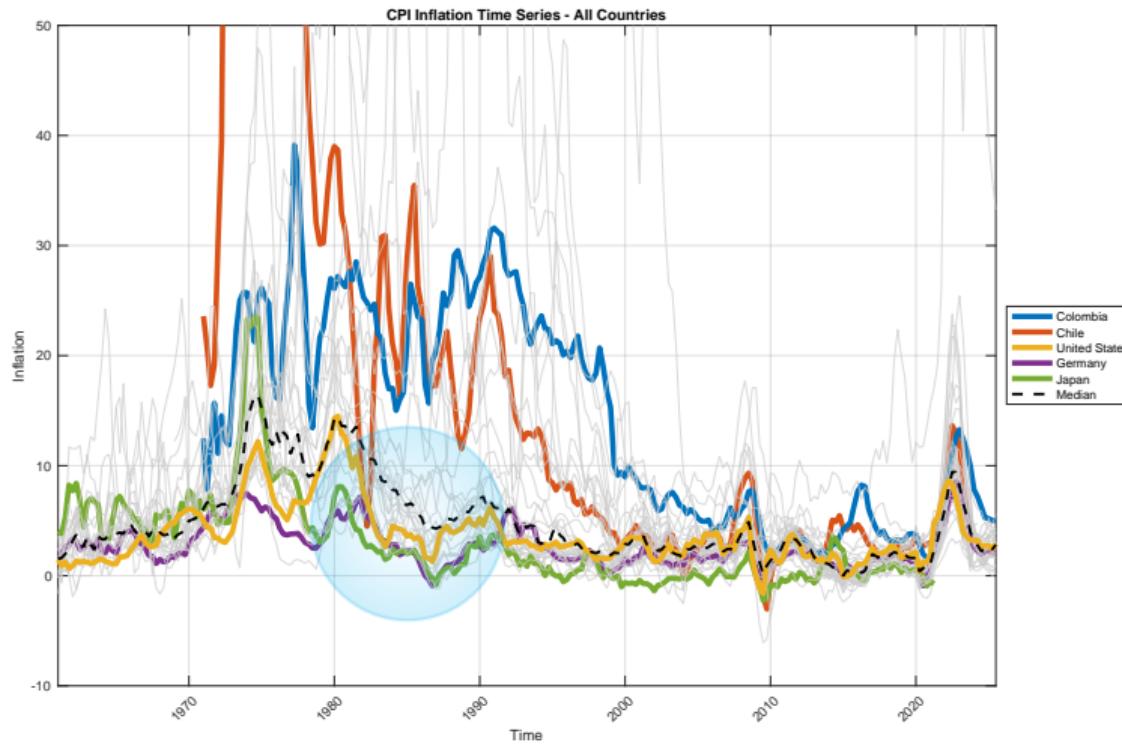
Inflation across space and time

- High and **volatile** inflation in several OECD countries in the 1960s and 1970s



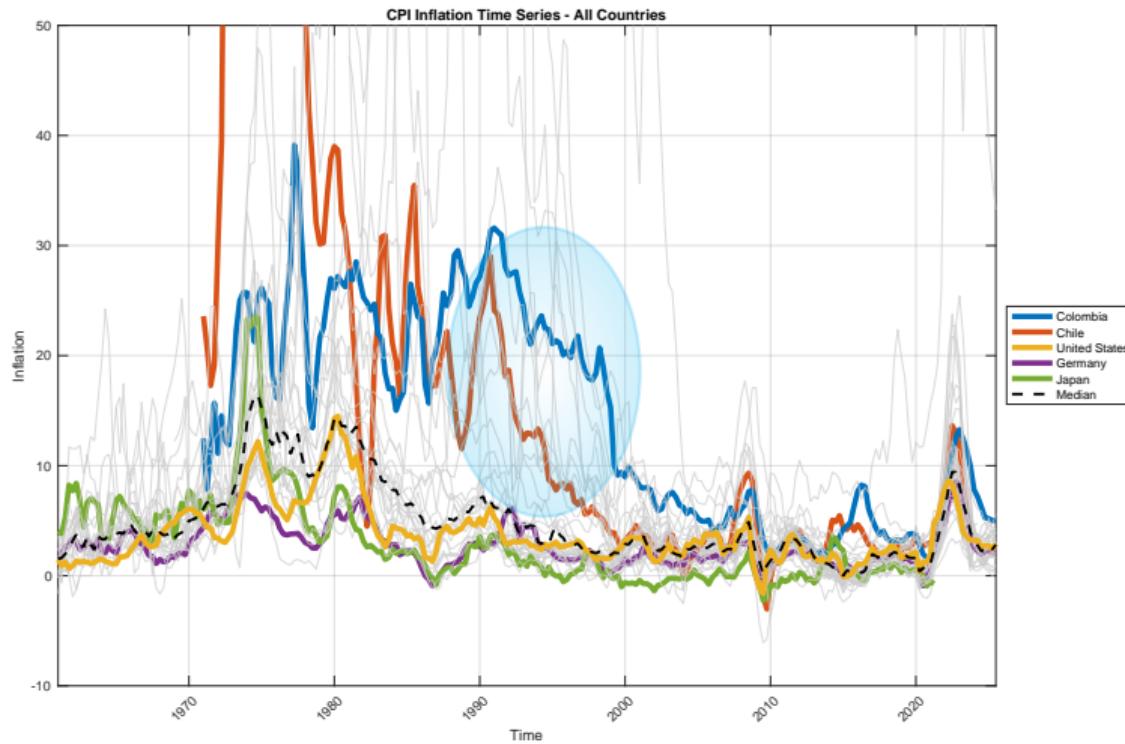
Inflation across space and time

- Break for advanced economies starting from the 1980s



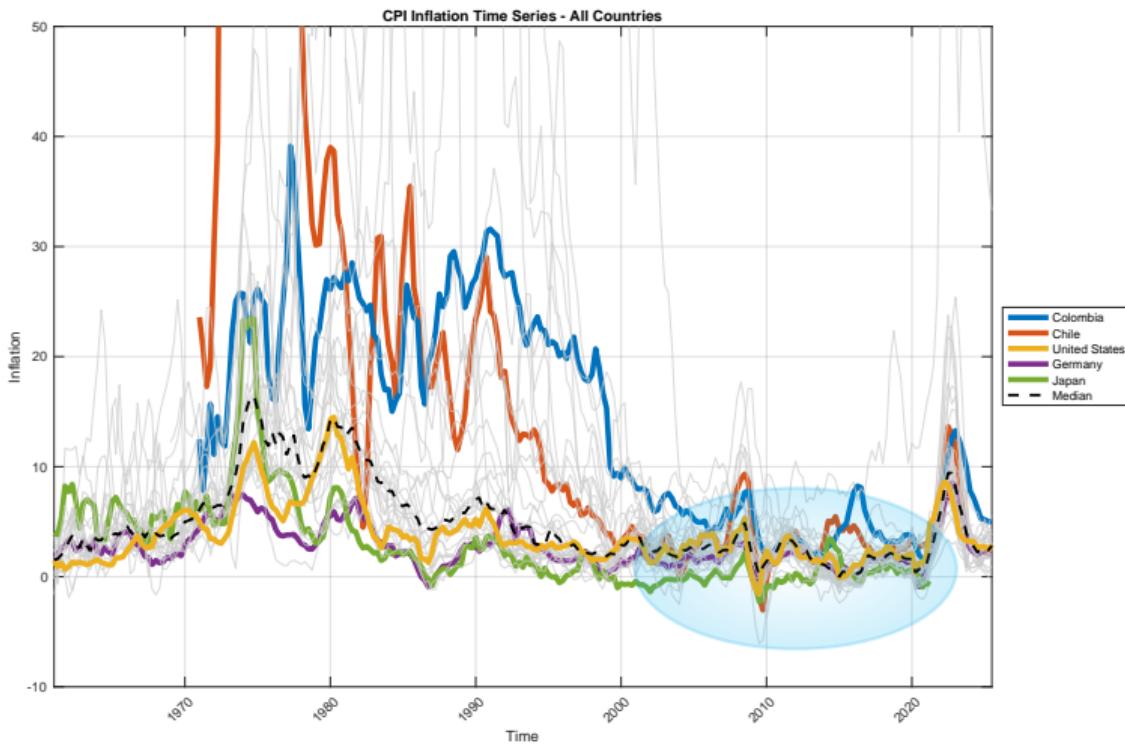
Inflation across space and time

- Break in the 1990s for the other countries



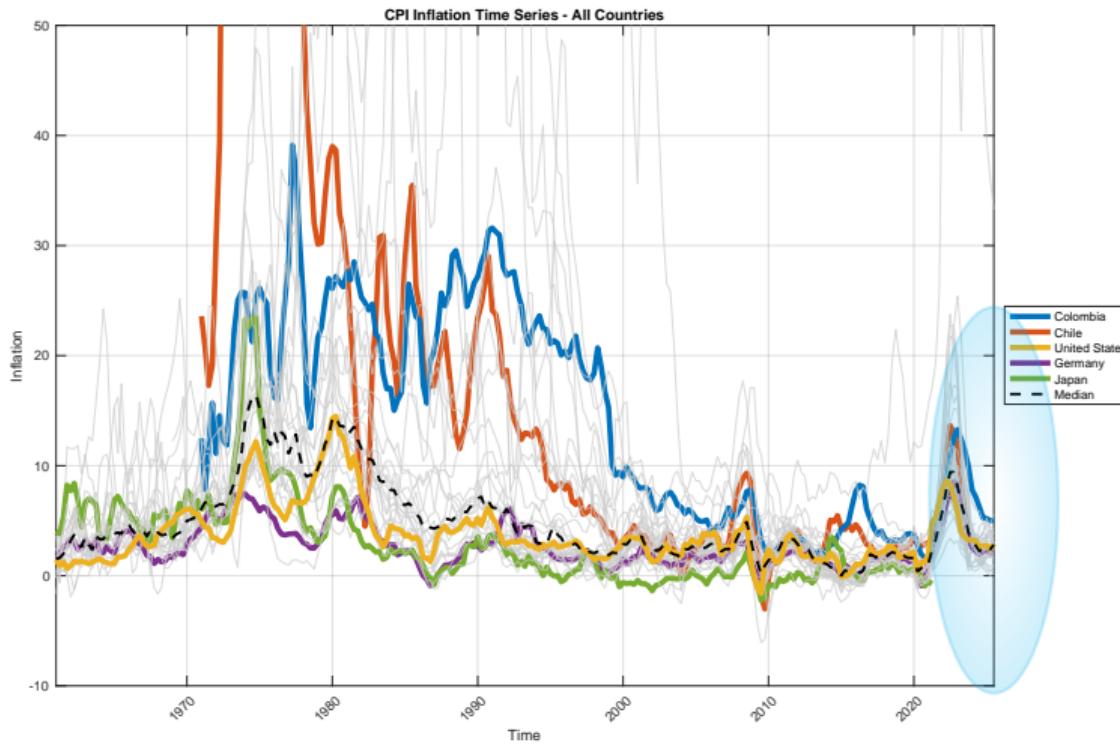
Inflation across space and time

- Remarkable convergence to **low** and **stable** inflation across countries in the 1990s



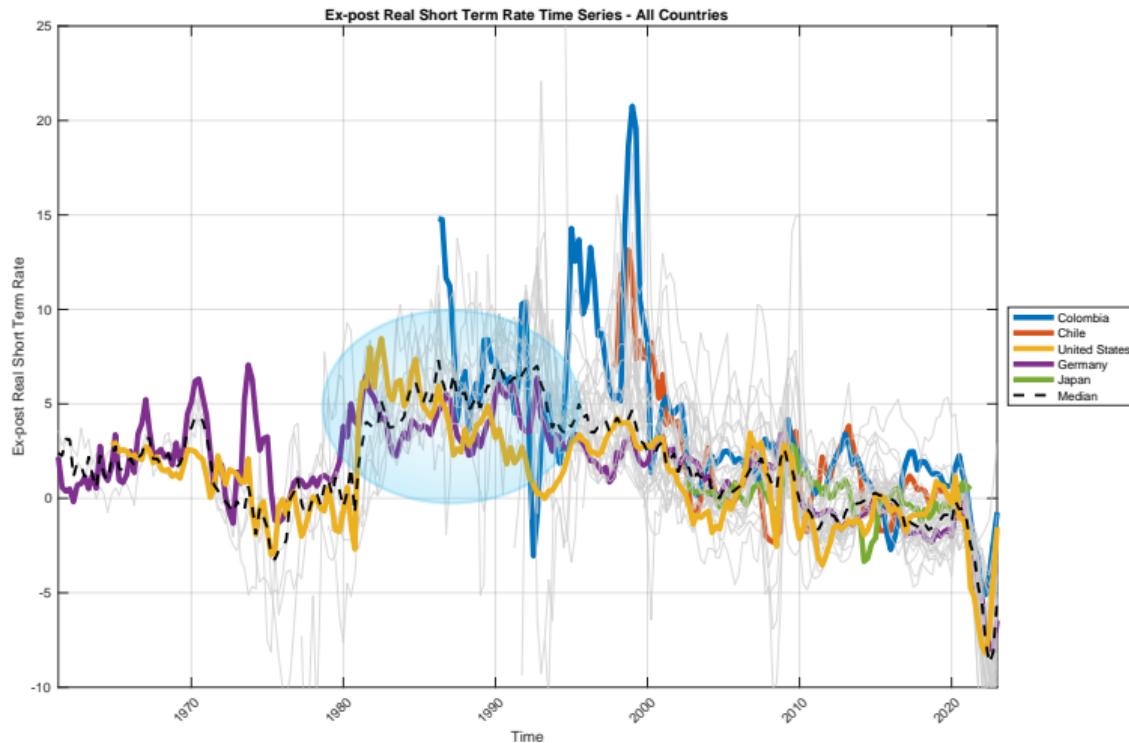
Inflation across space and time

- Large spur of inflation after the pandemic



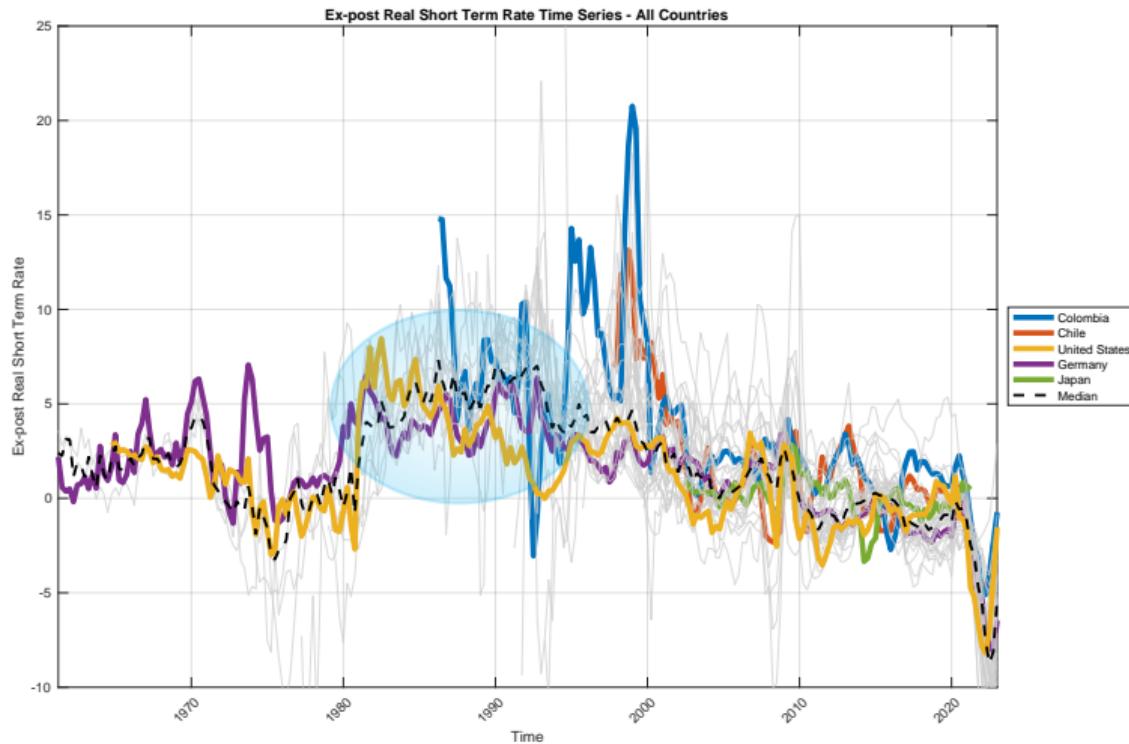
Large swings in real interest rates

- Decline in inflation associated with a prolonged period of high real interest rates



Large swings in real interest rates

- Shift made possible by structural reforms making central banks independent



The conquest of inflation and central bank independence

- Key role of central bank independence in conquest of inflation
- Natural to ask what would happen if central bank independence were lost once again
- What is central bank independence? Independence from whom?
 - ① An institutional arrangement that creates arm's-length separation between the political branch (fiscal policy) and the central bank.
 - ② It grants the central bank operational autonomy in pursuing goals set by elected officials

Why is central bank independence necessary?

Central bank independence is a **second best solution**:

- ➊ **Ideally**, monetary and fiscal authorities would work in tandem for the greater good
- ➋ **In reality**, politicians rarely hold neutral views on **spending** or **monetary policy**:
 - Strong incentives to cushion contractionary shocks, less concerns about expansions
 - Expansionary fiscal policy is politically attractive ⇒ **inflation bias**
- ➌ An **operationally independent central bank** serves as a safeguard that **markets** rely on to prevent fiscal excesses

Role of fiscal policy for inflation well understood for **emerging economies**, but recent contributions show that **fiscal inflation** matters also for **advanced economies**:

- Bianchi and Ilut (2017) estimate a model with policy regime changes and find that the Volcker disinflation as a shift from a **Fiscally-led** to a **Monetary-led** regime

Fiscal inflation in the US

- 1960s-1970s: Lack of central bank independence + large spending \Rightarrow Great Inflation

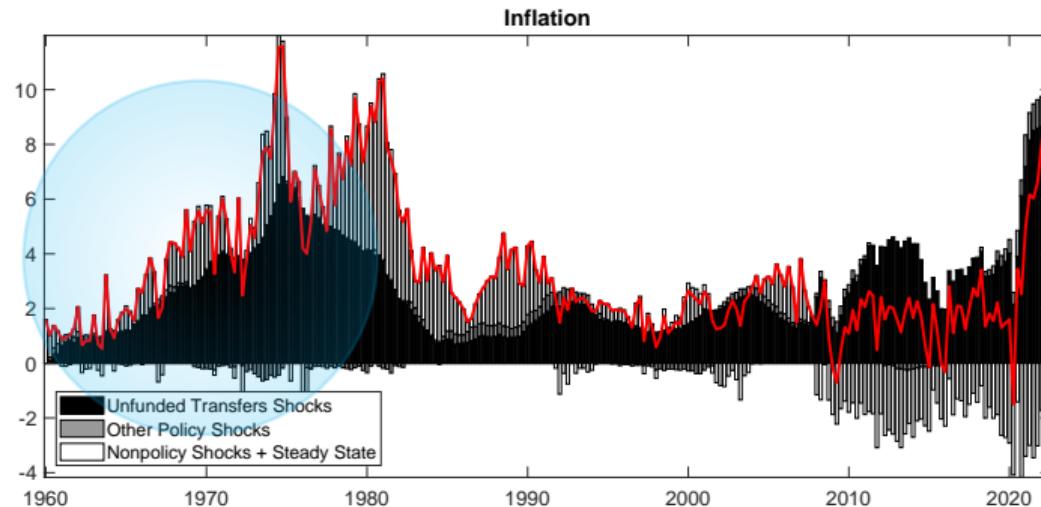


Figure: Fiscal inflation in the United States (black area).
Based on Bianchi, Faccini, Melosi (QJE, 2023)

Fiscal inflation in the US

- 1980s: Central bank independence + fiscal backing \Rightarrow **Disinflation**

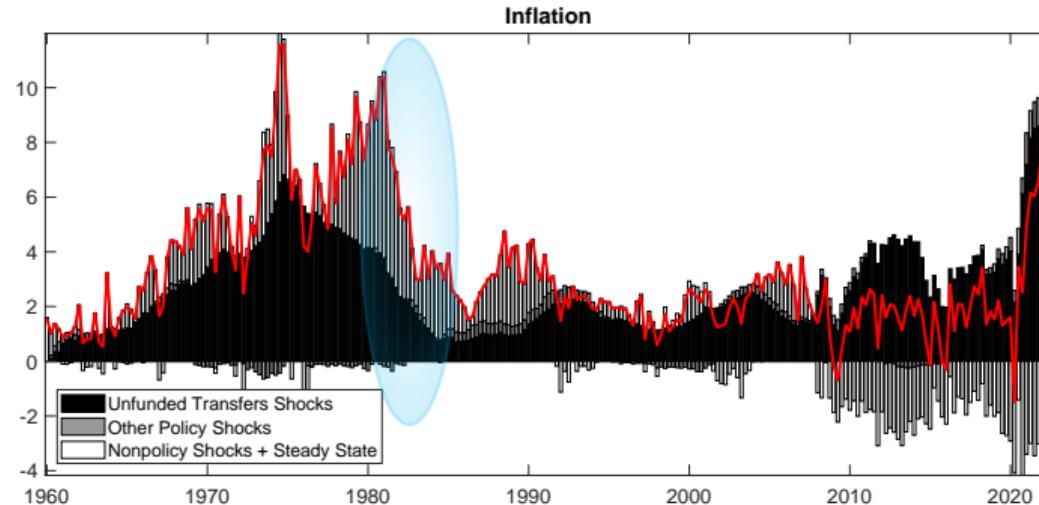


Figure: Fiscal inflation in the United States (black area).
Based on Bianchi, Faccini, Melosi (QJE, 2023)

Fiscal inflation in the US

- Fiscal inflation does not disappear:

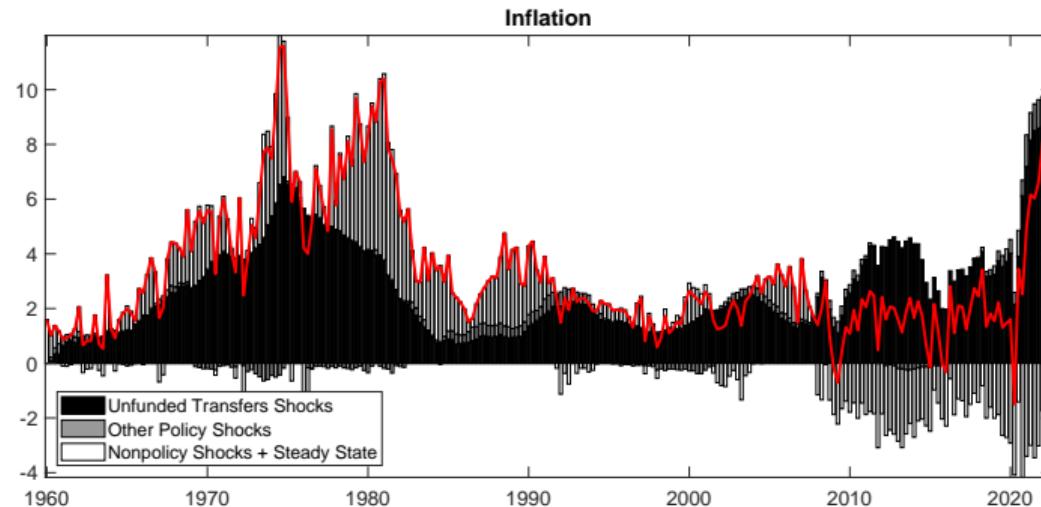


Figure: Fiscal inflation in the United States (black area).
Based on Bianchi, Faccini, Melosi (QJE, 2023)

Fiscal inflation in the US

- It increases after recessions

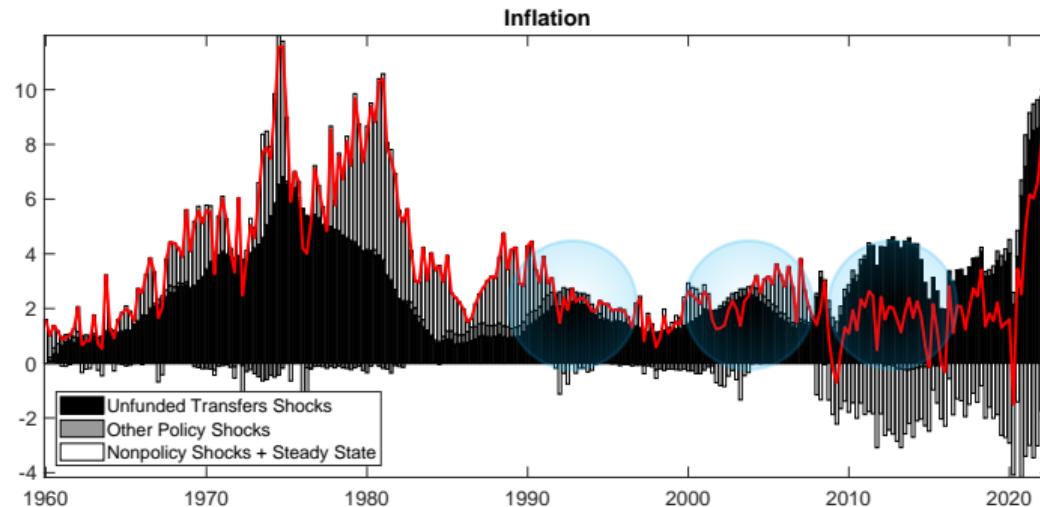


Figure: Fiscal inflation in the United States (black area).
Based on Bianchi, Faccini, Melosi (QJE, 2023)

Fiscal inflation in the US

- It offsets the deflationary pressure in the post-Millennial period

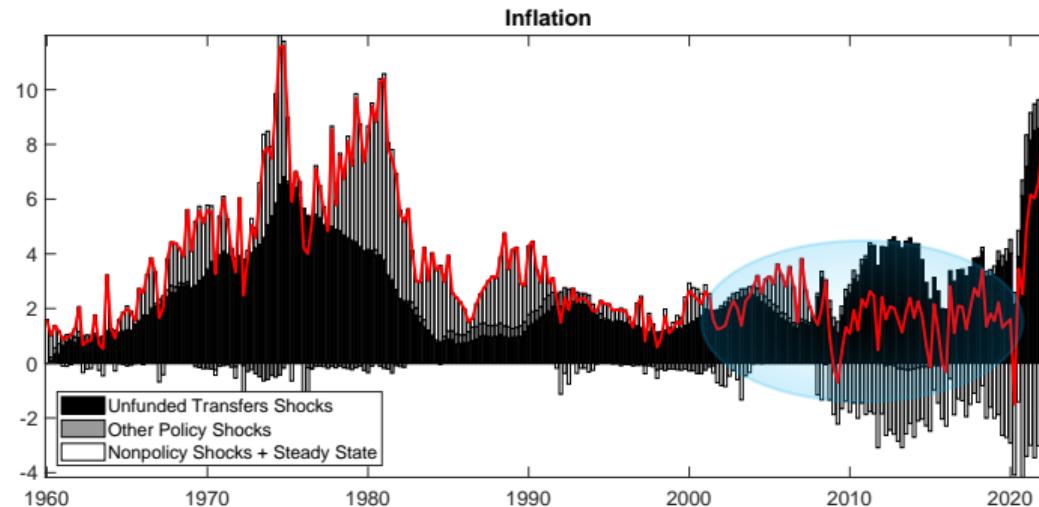


Figure: Fiscal inflation in the United States (black area).
Based on Bianchi, Faccini, Melosi (QJE, 2023)

Fiscal inflation in the US

- It accounts for post-pandemic inflation (see also Barro-Bianchi, 2025)

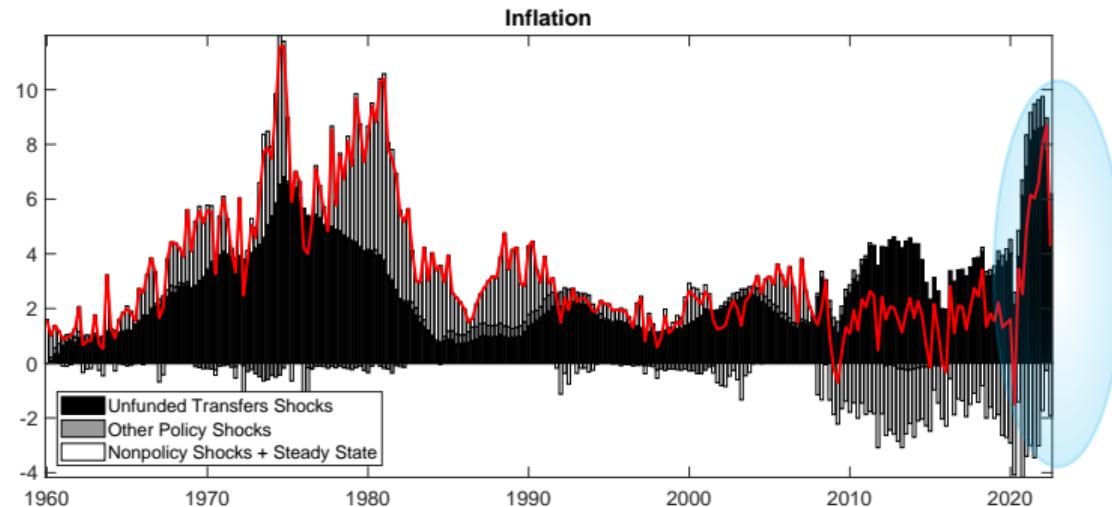
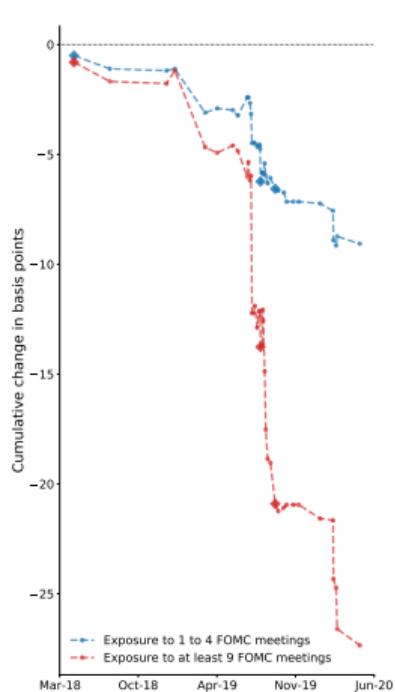


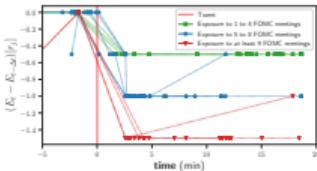
Figure: Fiscal inflation in the United States (black area).
Based on Bianchi, Faccini, Melosi (QJE, 2023)

Threats to Central Bank Independence (Bianchi et. al, JME 2023)

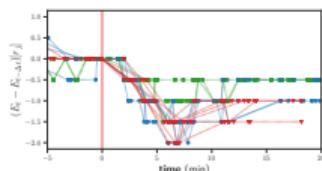
- Does political pressure "work"? And if so, in which sense?



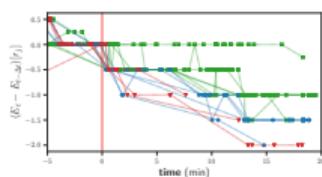
(a) Cumulative plot



(b) First tweet (2018-04-16)



(c) Tweet (2019-08-23)

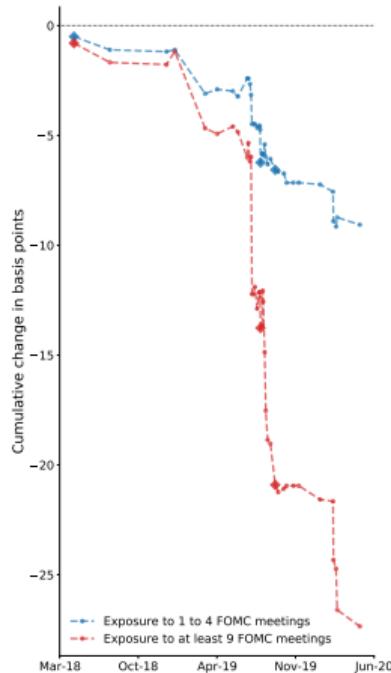


(d) Tweet (2019-10-01)

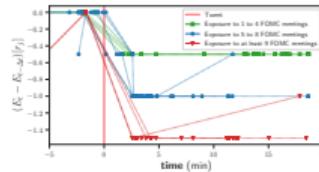
Figure: President Trump's Tweets and market expectations during his first term.

Threats to Central Bank Independence (Bianchi et. al, JME 2023)

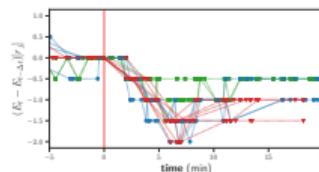
- President Trump publicly criticized the Fed during his first term



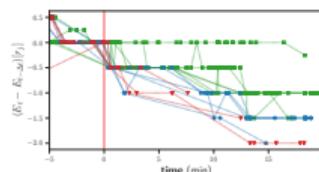
(a) Cumulative plot



(b) First tweet (2018-04-16)



(c) Tweet (2019-08-23)

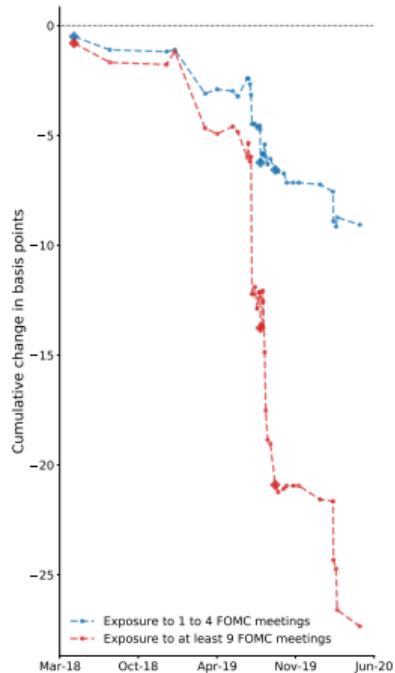


(d) Tweet (2019-10-01)

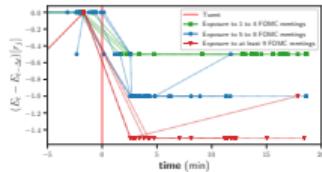
Figure: President Trump's Tweets and market expectations during his first term.

Threats to Central Bank Independence (Bianchi et. al, JME 2023)

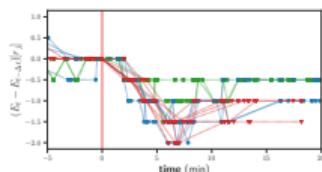
- The novelty was the use of social media (Twitter/X) providing precise time stamps



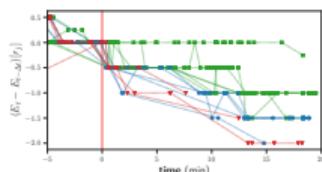
(a) Cumulative plot



(b) First tweet (2018-04-16)



(c) Tweet (2019-08-23)

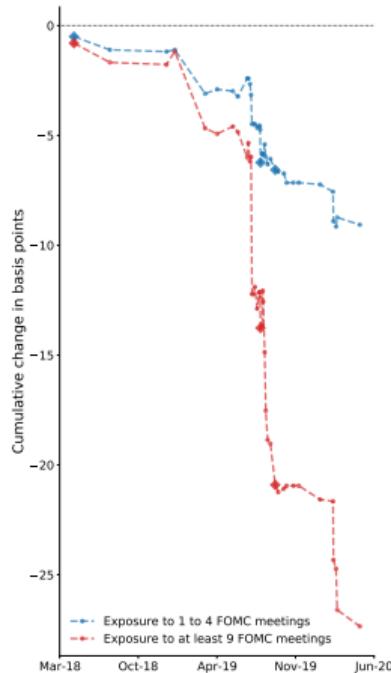


(d) Tweet (2019-10-01)

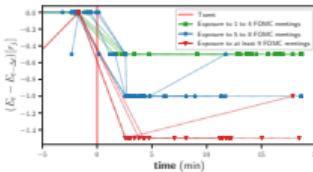
Figure: President Trump's Tweets and market expectations during his first term.

Threats to Central Bank Independence (Bianchi et. al, JME 2023)

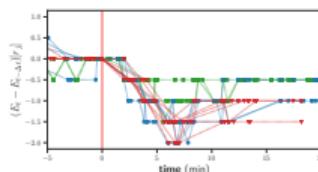
- Tweets lowered market expectations about FFR in the minutes after



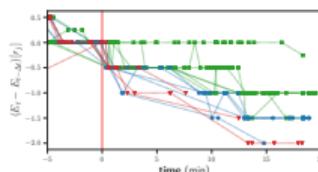
(a) Cumulative plot



(b) First tweet (2018-04-16)



(c) Tweet (2019-08-23)



(d) Tweet (2019-10-01)

Figure: President Trump's Tweets and market expectations during his first term.

Threats to Central Bank Independence (Bianchi et. al, JME 2023)

- Eventually the Fed **paused** and then **reverted** interest rate path

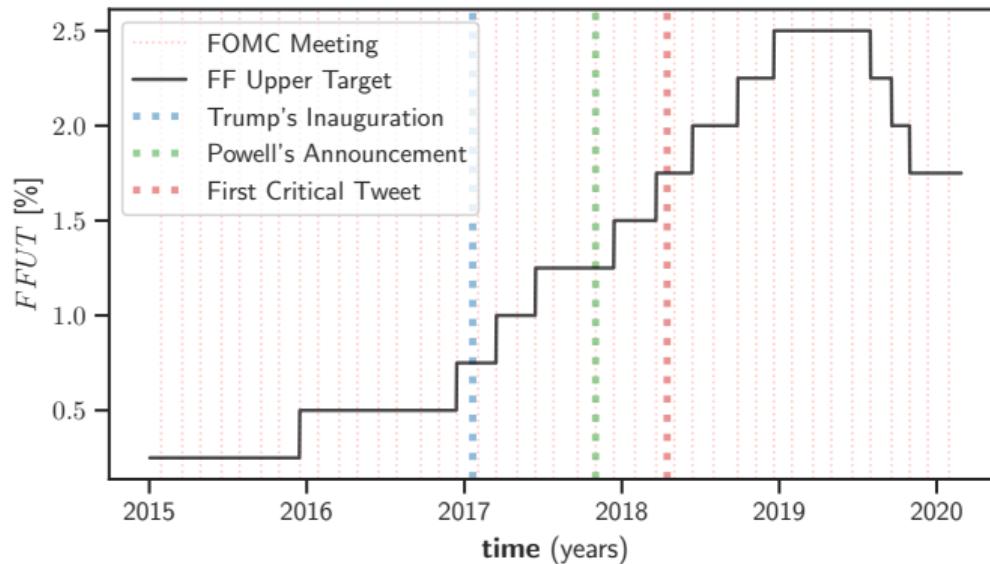


Figure: Path of FFR during President Trump's first term.
Based on Bianchi, et al. (JME, 2023)

Threats to Central Bank Independence (Bianchi et. al, JME 2023)

- Using a VAR, we provide evidence that pressure played a role in the reversal

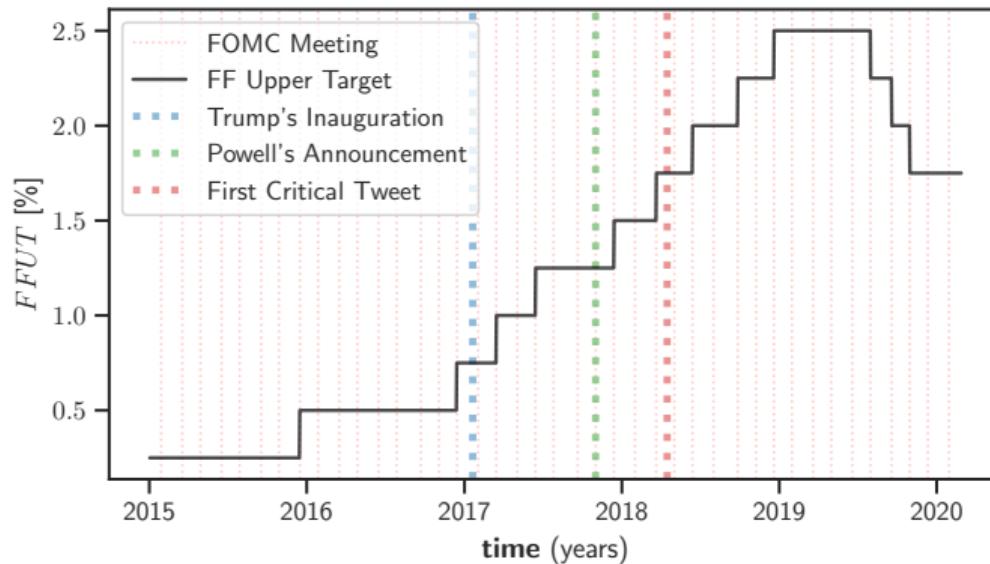


Figure: Path of FFR during President Trump's first term.
Based on Bianchi, et al. (JME, 2023)

Threats to Central Bank Independence (Bianchi et. al, JME 2023)

- Was the President right? Did pressure "work"?

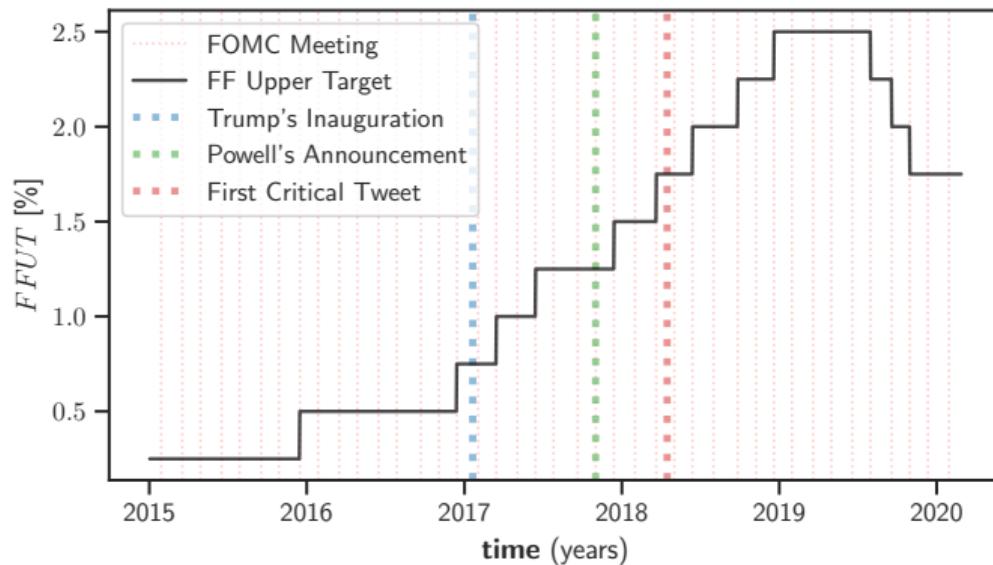
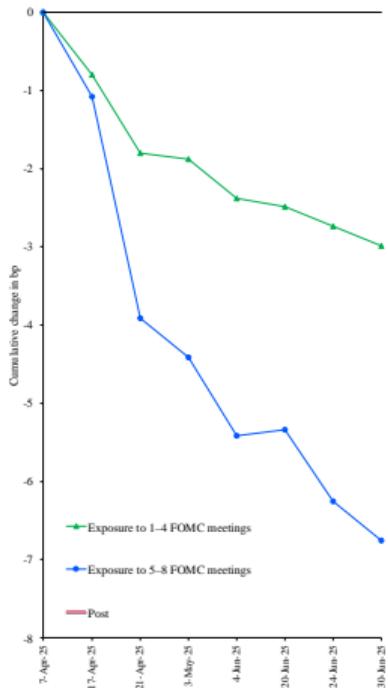


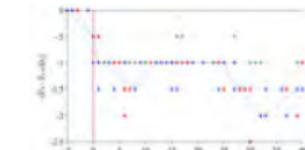
Figure: Path of FFR during President Trump's first term.
Based on Bianchi, et al. (JME, 2023)

Threats to Central Bank Independence (January-June 2025)

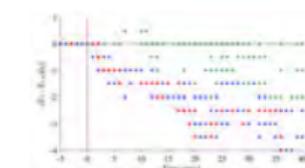
- Criticism resumed during President Trump's second term



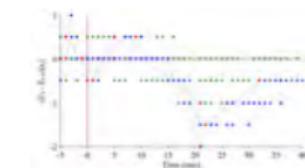
(a) Cumulative plot



(b) Post (2025-04-17)



(c) Post (2025-04-21)

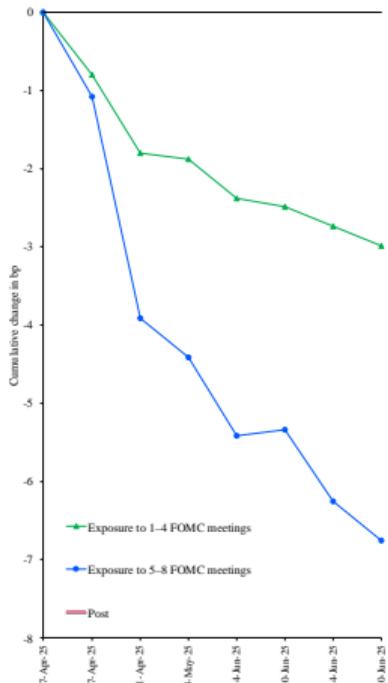


(d) Post (2025-06-04)

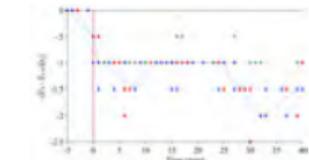
Figure: 2025 posts and market expectations

Threats to Central Bank Independence (January-June 2025)

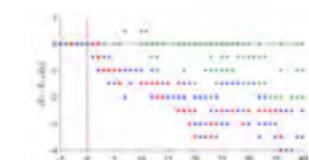
- 2025 posts were also associated with lower expectations for the FFR



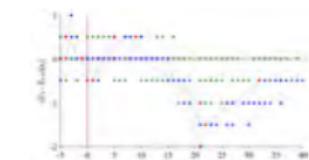
(a) Cumulative plot



(b) Post (2025-04-17)



(c) Post (2025-04-21)

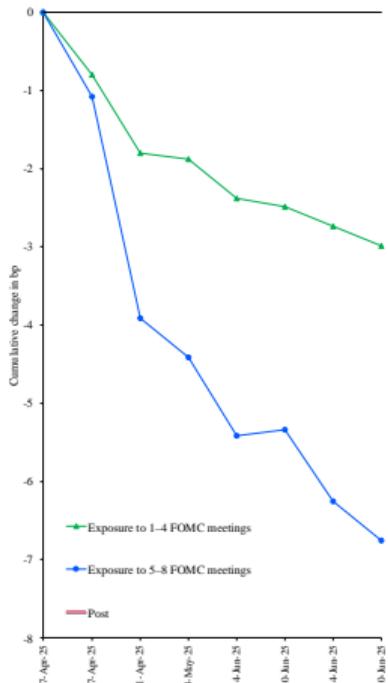


(d) Post (2025-06-04)

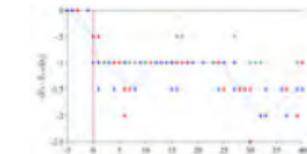
Figure: 2025 posts and market expectations

Threats to Central Bank Independence (January-June 2025)

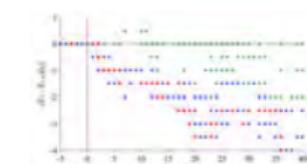
- Effect stronger at longer horizons, but...



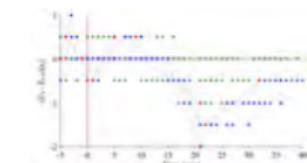
(a) Cumulative plot



(b) Post (2025-04-17)



(c) Post (2025-04-21)

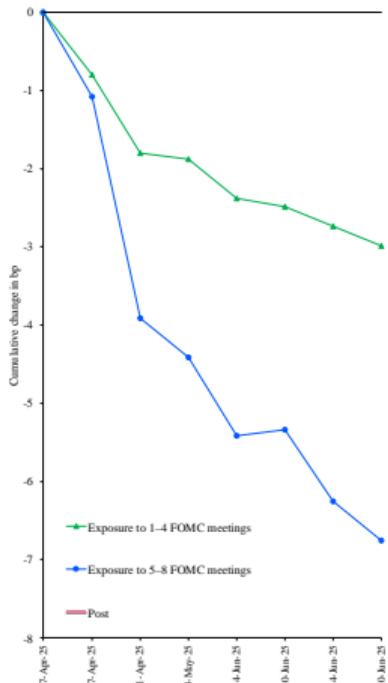


(d) Post (2025-06-04)

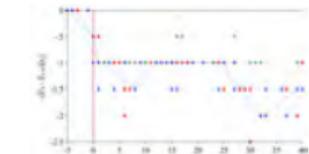
Figure: 2025 posts and market expectations

Threats to Central Bank Independence (January-June 2025)

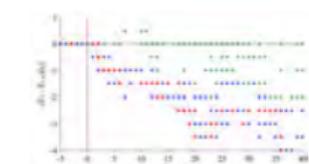
- ...no apparent decline in longer yields and mortgage rates (at daily frequency)



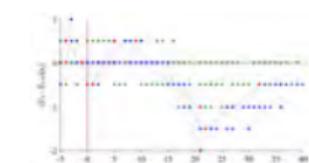
(a) Cumulative plot



(b) Post (2025-04-17)



(c) Post (2025-04-21)

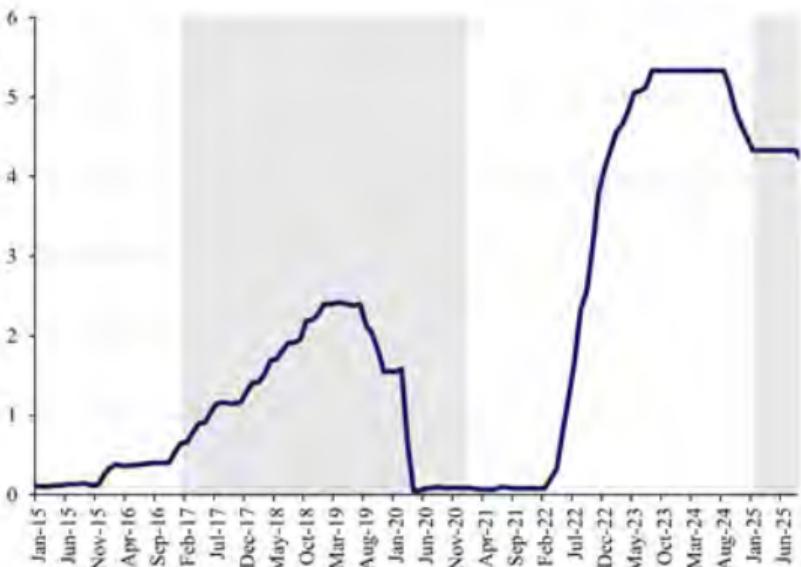


(d) Post (2025-06-04)

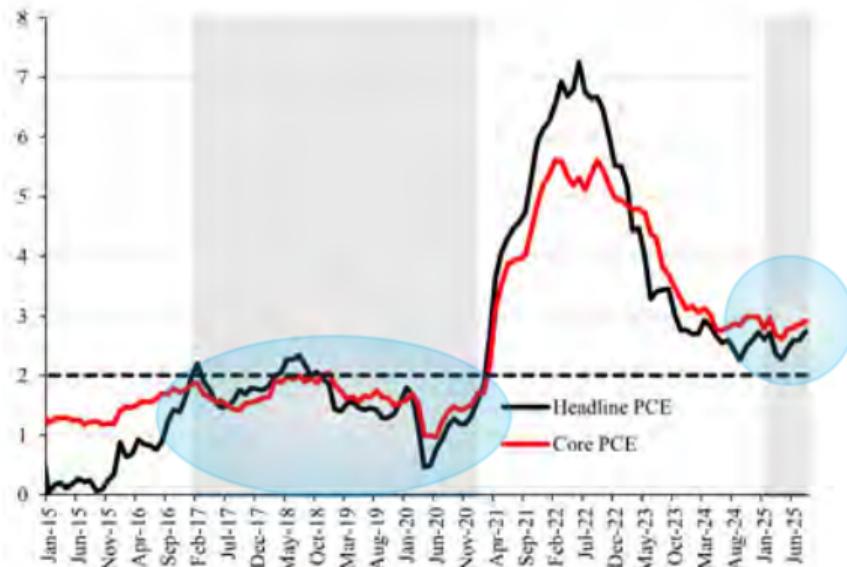
Figure: 2025 posts and market expectations

Threats to Central Bank Independence (January-June 2025)

- Why? Very different situation, with inflation still above target



(b) Federal Funds Rate



(b) PCE Inflation

Figure: Federal Funds Rate and PCE Inflation. Gray areas denote President Trump's terms.

Conclusions

- Central bank independence **necessary** for low and stable inflation
- The issue is not whether central banks can make mistakes or not, but rather whether replacing them with more political agents would represent an improvement
- A certain level of political pressure is **unavoidable**, but institutional norms matter
- In **everyone's best interest** to preserve "the myth of the autonomous Fed" (Nixon):
 - Political pressure can lower short-term rates, but **not necessarily long-term rates**
 - Inflation, inflation expectations, and premia tightly linked to central bank independence
 - At the moment, **markets seem to bet that Fed independence will ultimately be preserved**