

Central Bank Independence, Credibility, and Market Responses

Prepared for Peterson Institute Conference “Central Bank Independence in Practice,” October 31, 2025

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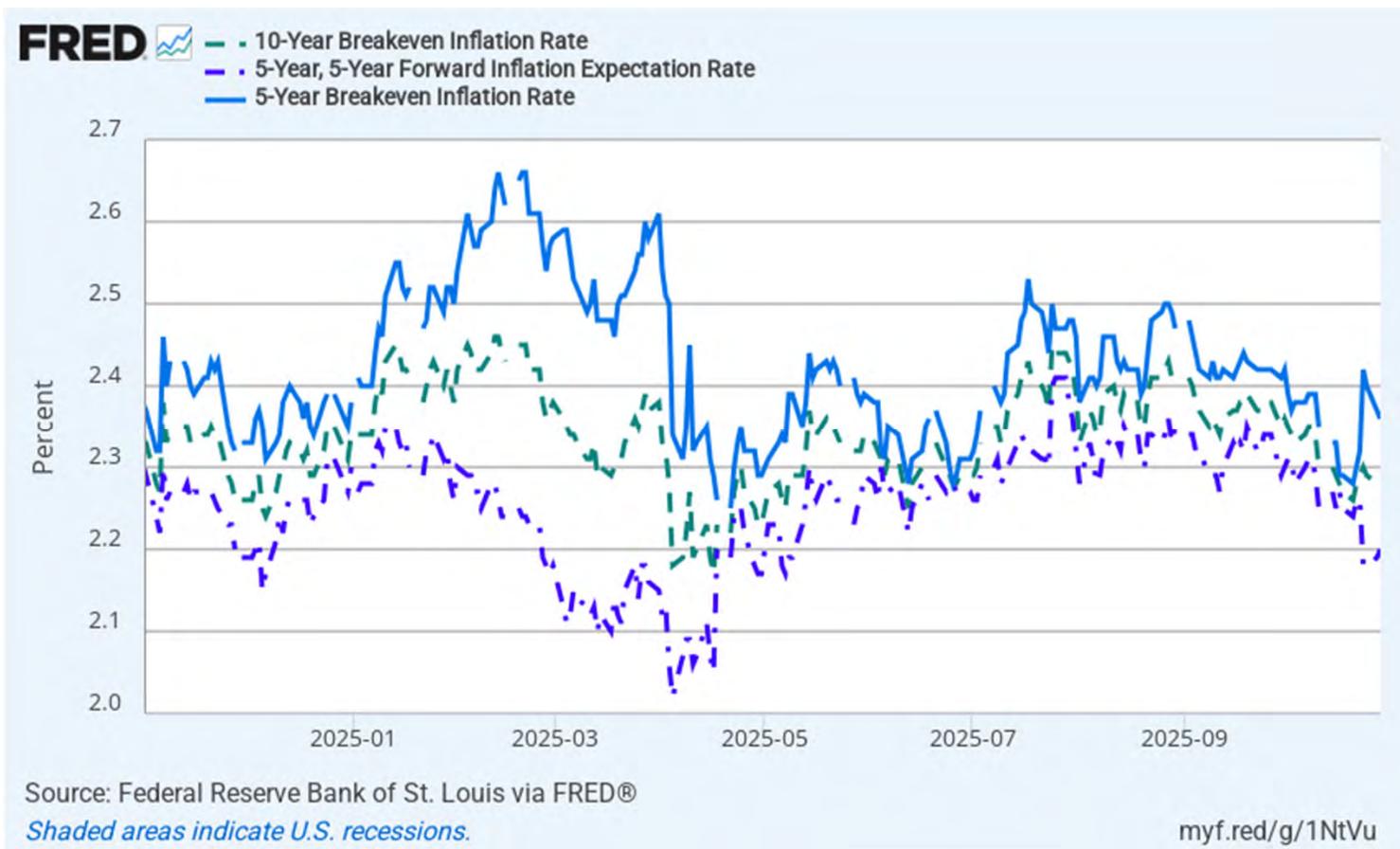
Key Questions

- Independence
 - Definition?
 - A means to an end (e.g., “credibility”) or end in itself?
 - Role of supervision and regulation?
- Credibility
 - What drives expectations, markets, and behavior?
- Objectives and Outcomes
 - How do independence and credibility affect achievement of objectives?
 - How achieve optimal trade-offs?
- Market Responses
 - How have markets reacted to questions about independence?
 - Why?

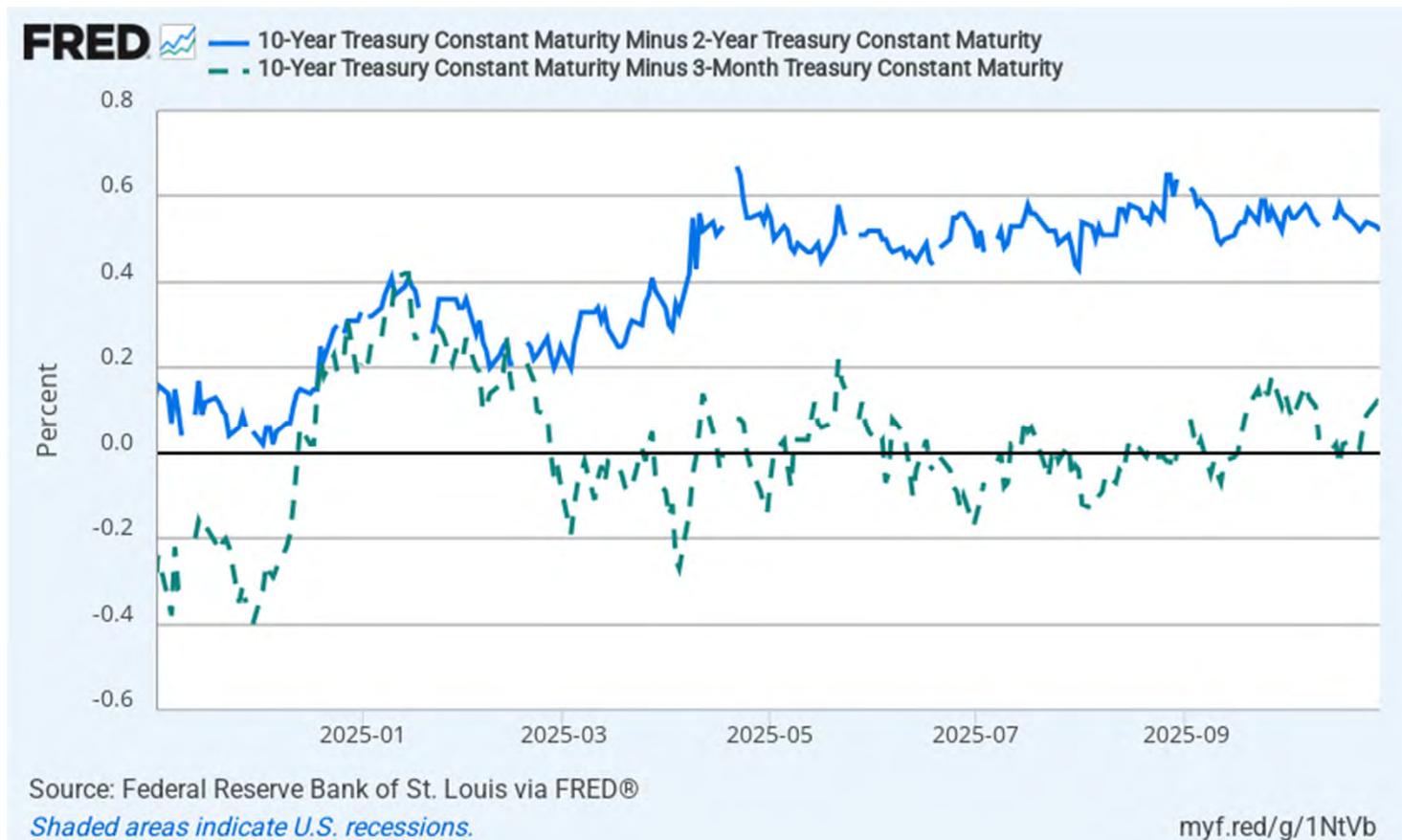
Market Reactions or Lack Thereof

- Examine a variety of market indicators
- All charts begin on Nov 1, 2024
- Criticism of the Fed intensifies late April 2025
 - Up, Mixed, Flat are relative to late April 2025

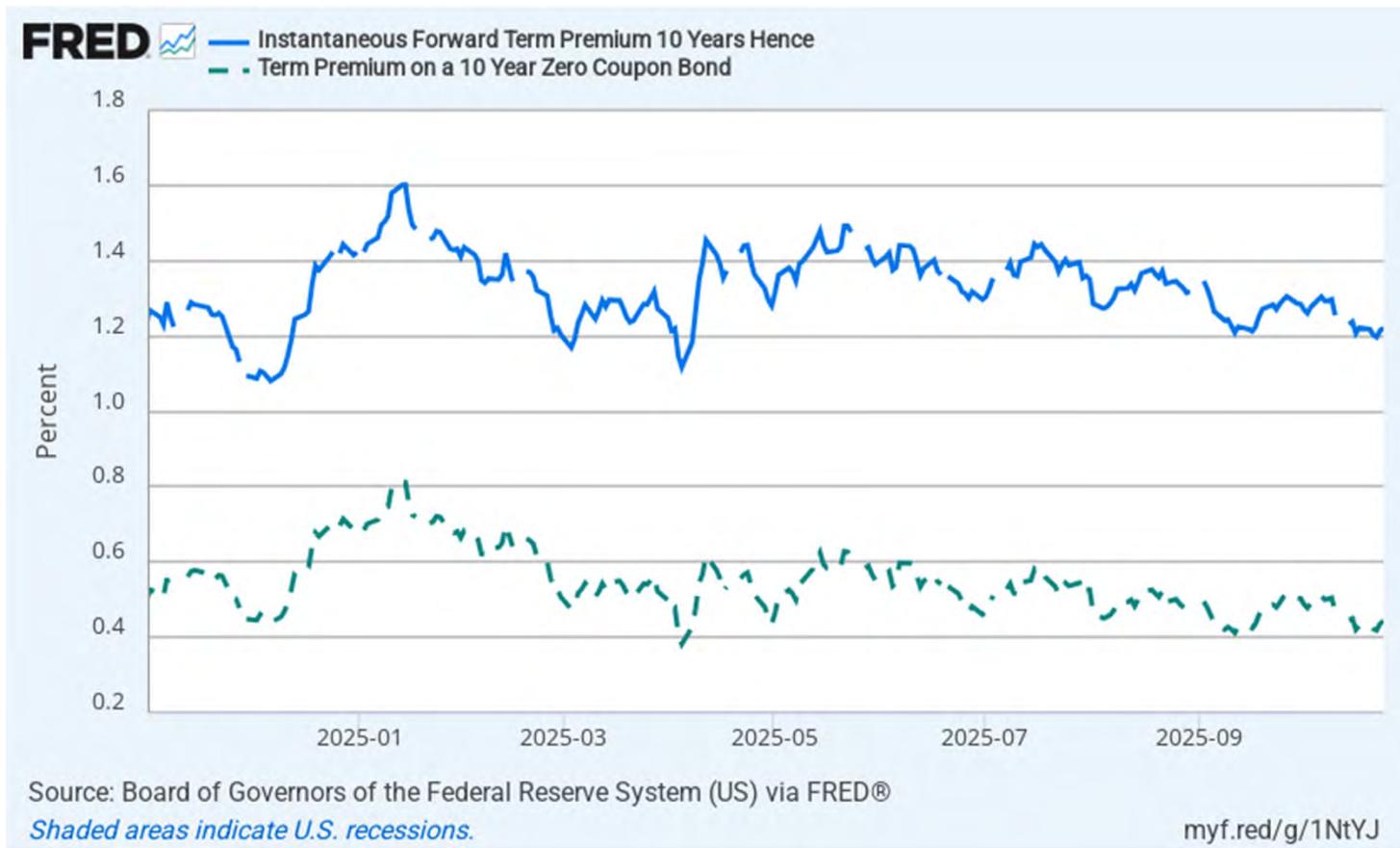
Longer Horizon Inflation Expectations: Flat



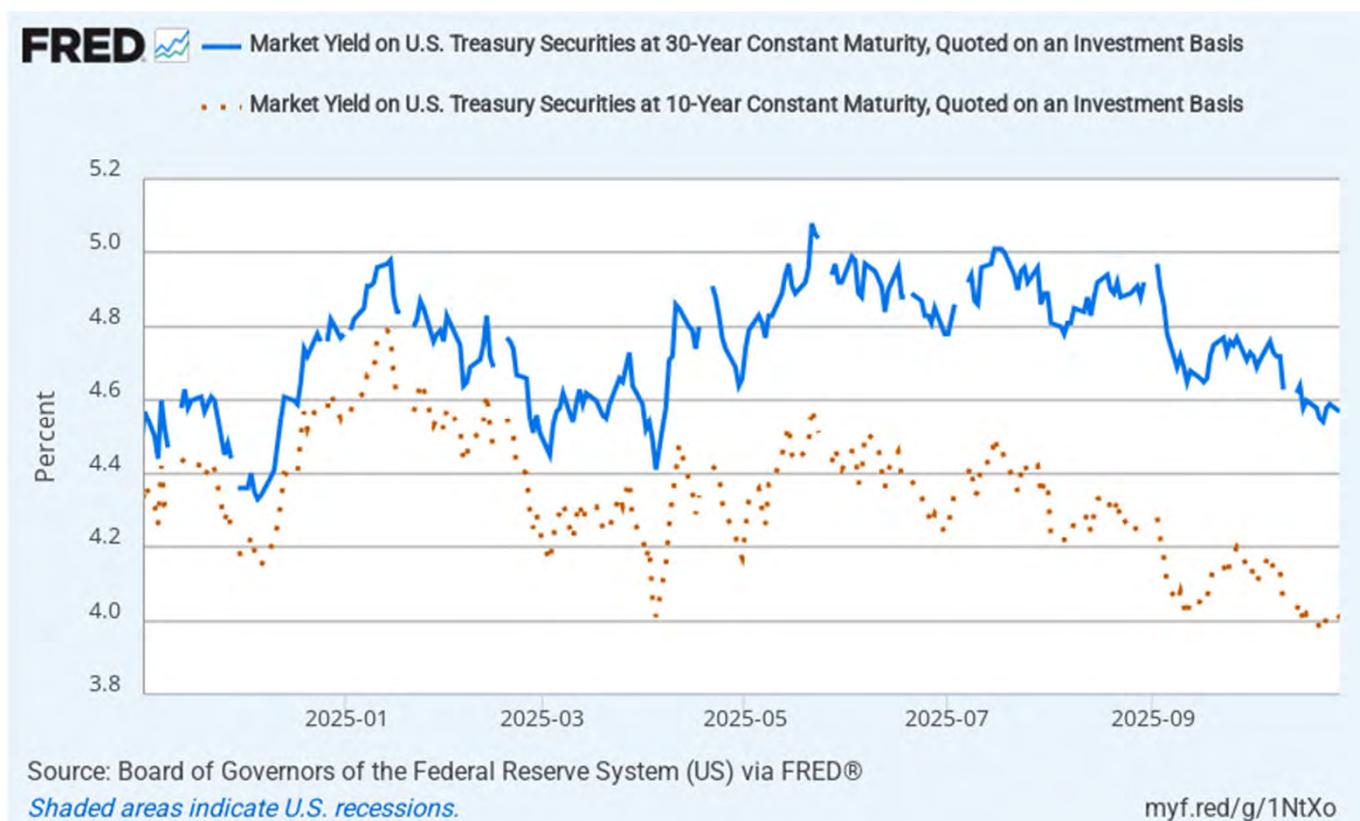
Yield Curve: Flat



10-year Term Premium: Flat



Long-term Nominal Interest Rates: Mixed



Value of the Dollar (WSJ Dollar Index): Flat

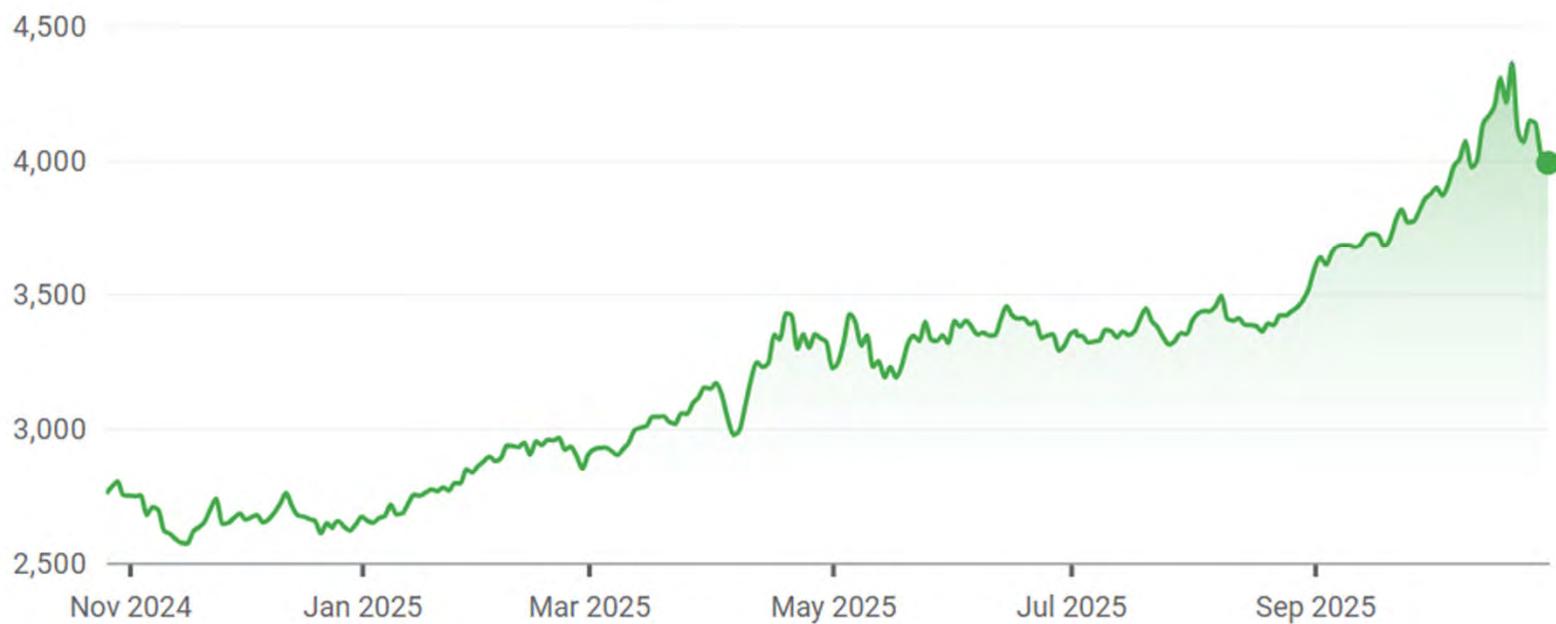
XX:BUXX



Gold: Up

Oct 29, 1:48:56 AM UTC · USD · COMEX · Disclaimer

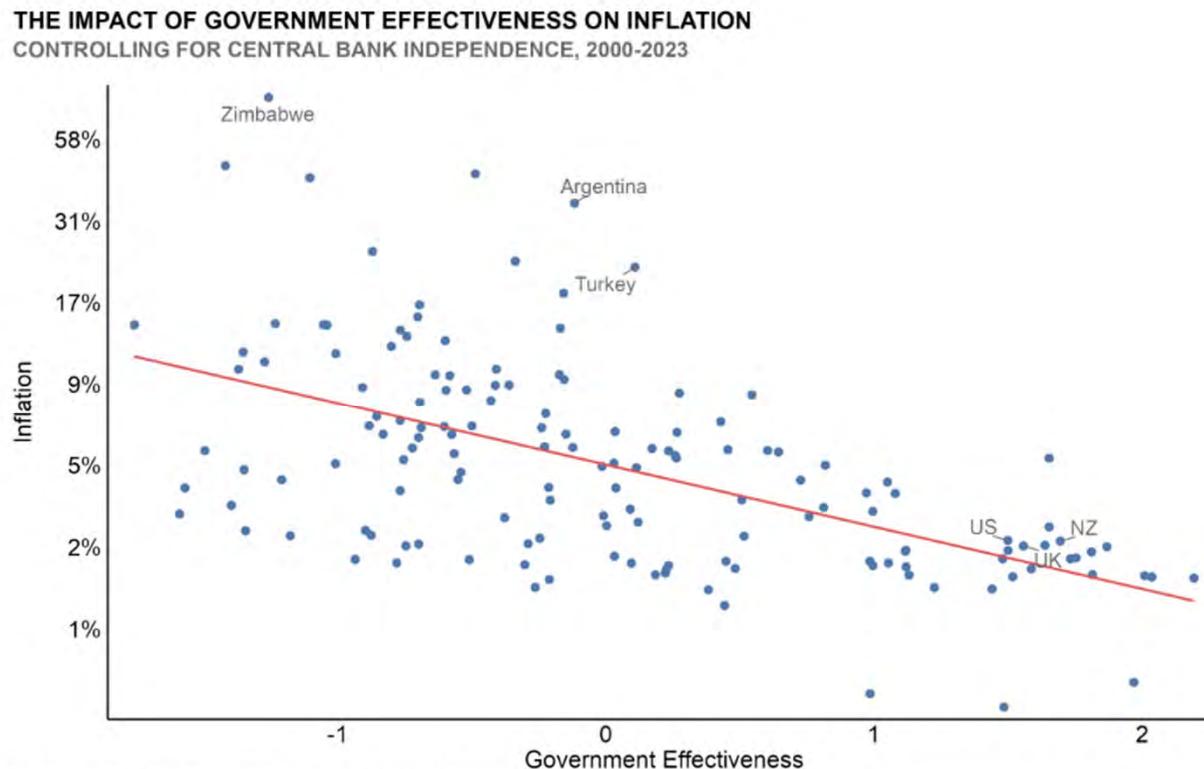
1D 5D 1M 6M YTD 1Y 5Y MAX



Alternative Interpretations

- 1) Markets are not aware/paying attention
 - Doubtful
- 2) Markets are wrong
 - Misunderstanding or misestimating the impact
 - An alternative is simply that the full impact is difficult to estimate and price
- 3) Markets are treating this as roughly “business as usual”
 - Markets may believe Fed is always under political pressure and now it is just more explicit
 - Role of broader institutional credibility, e.g., role of the Supreme Court
 - *Trump v Wilcox* (May 22, 2025): “*The Federal Reserve is a uniquely structured, quasi-private entity that follows in the distinct historical tradition of the First and Second Banks of the United States*” so decisions for other agencies such as NLRB do not “*necessarily implicate the constitutionality of for-cause removal protections for members of the Federal Reserve’s Board of Governors or other members of the Federal Open Market Committee.*”

Broader Role of Government Effectiveness (“Institutional Credibility;” Kuttner 2025)



Conclusions

- Independence
 - One means to an end
 - Part of a political process
 - Role for regulation and supervision
- Credibility
 - Broader role of institutional credibility
- Objectives and Outcomes
 - Broader political consensus is crucial
- Market Responses
 - Muted reactions due to central bank always being part of a political process and a broader focus on institutional credibility