

Central Bank Independence, Credibility, and Market Responses

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

Randall S. Kroszner ©

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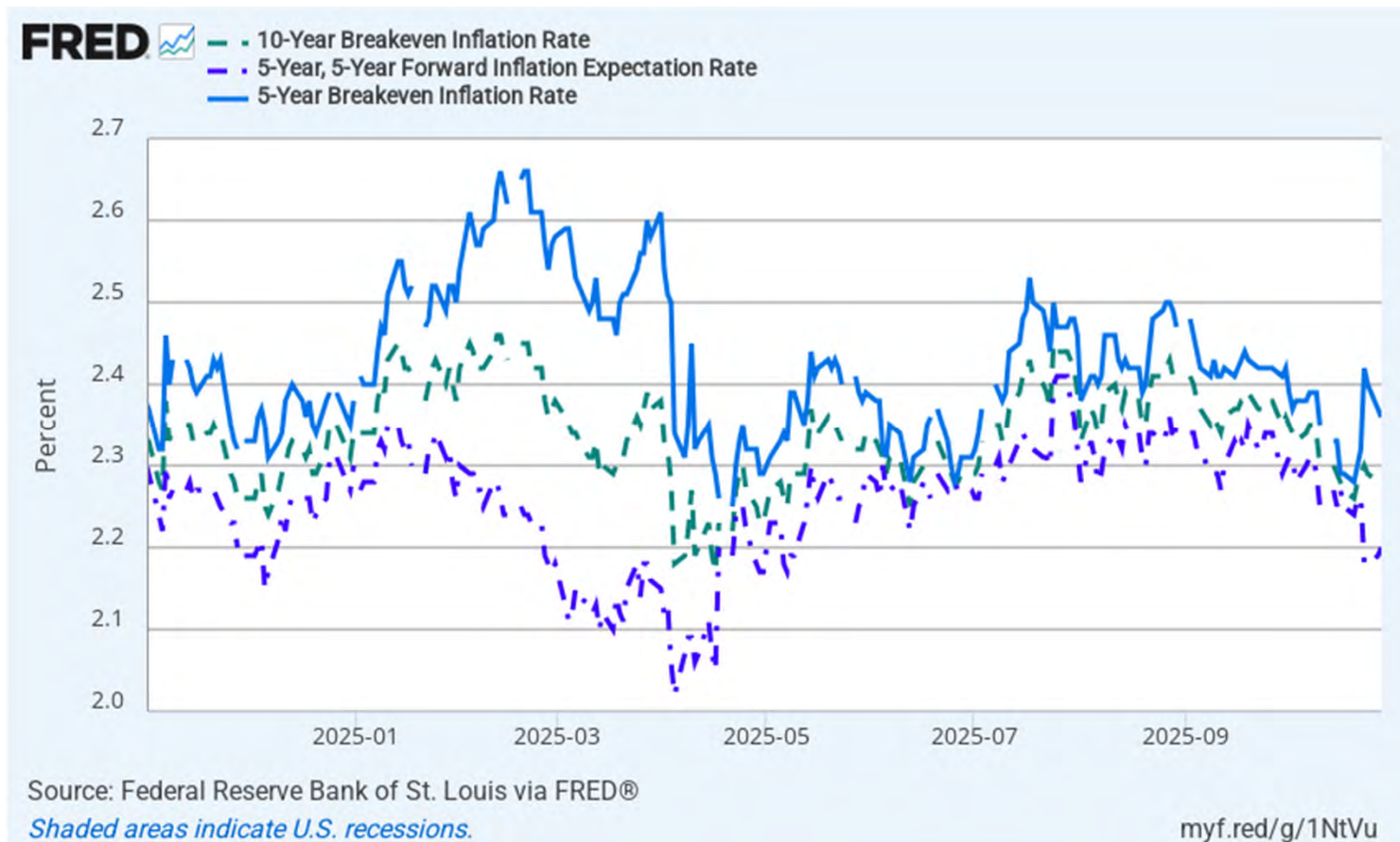
Key Questions

- 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?

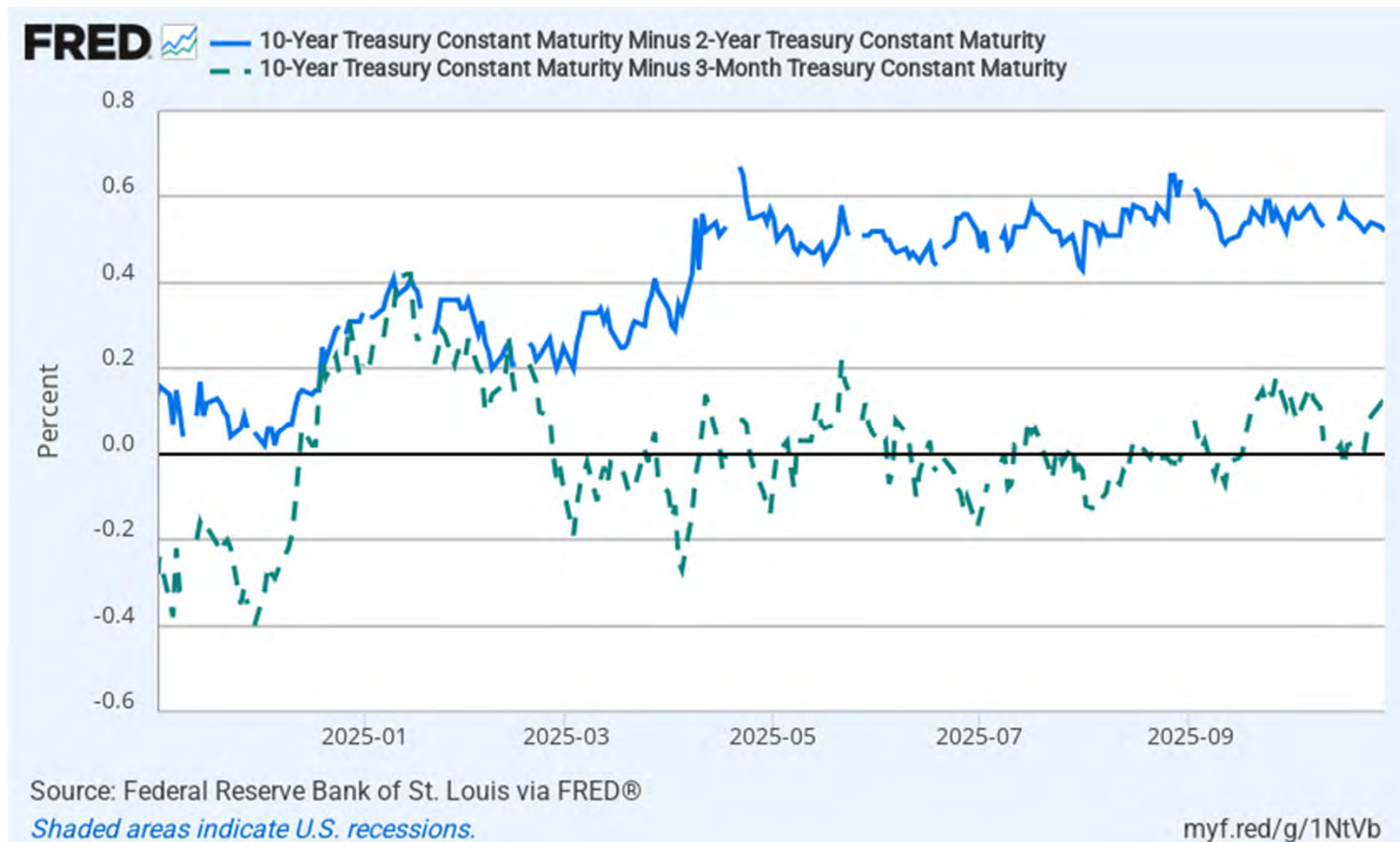
Market Reactions or Lack Thereof

- 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

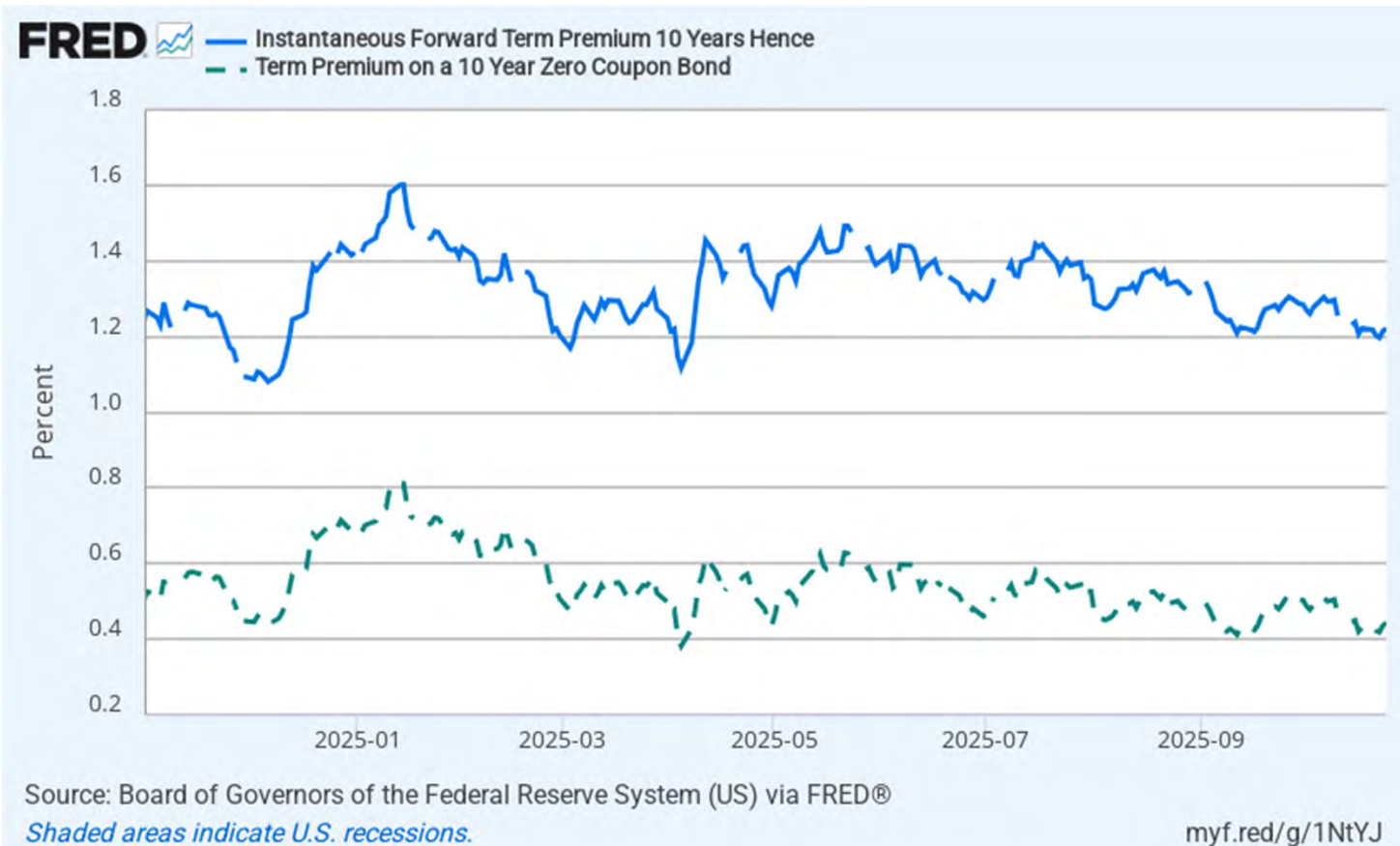
Longer Horizon Inflation Expectations: Flat



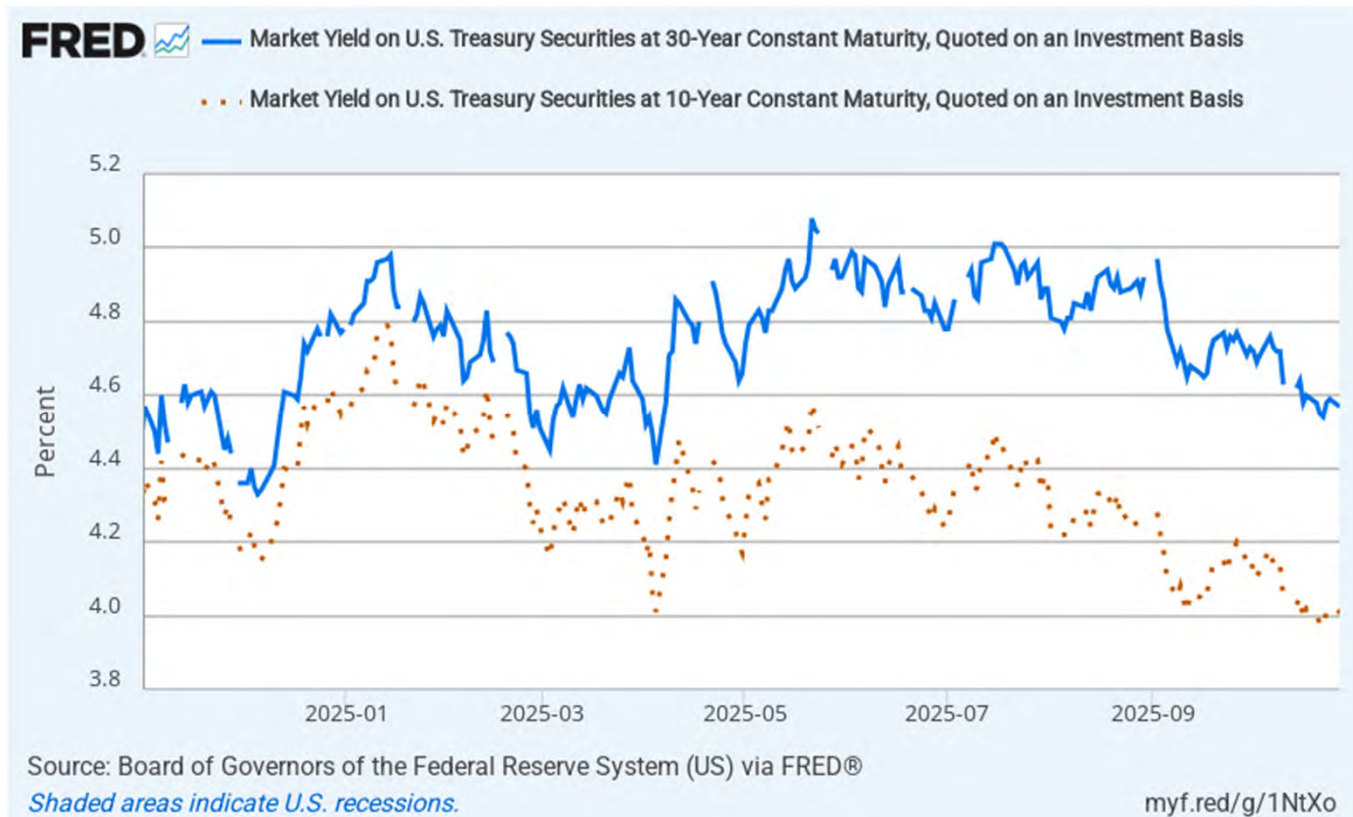
Yield Curve: Flat



10-year Term Premium: Flat



Long-term Nominal Interest Rates: Mixed



Value of the Dollar (WSJ Dollar Index): Flat

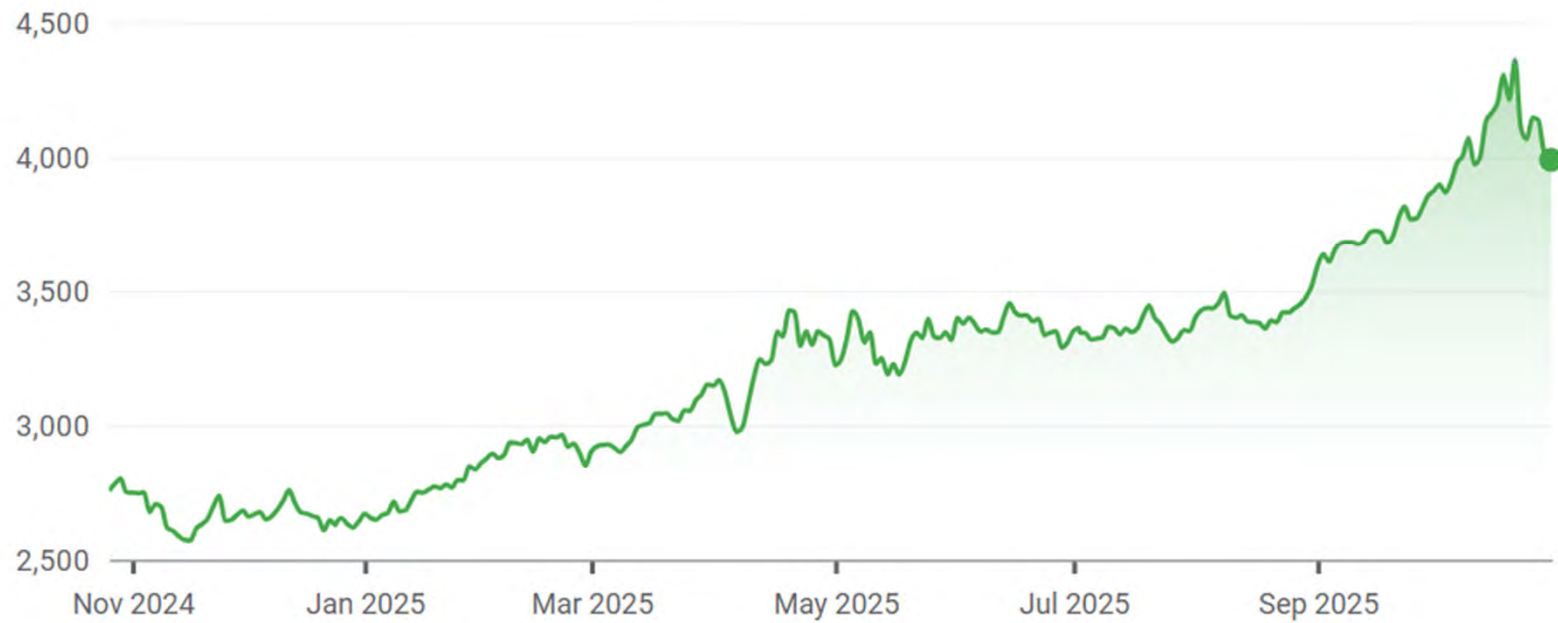
XX:BUXX



Gold: Up

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

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

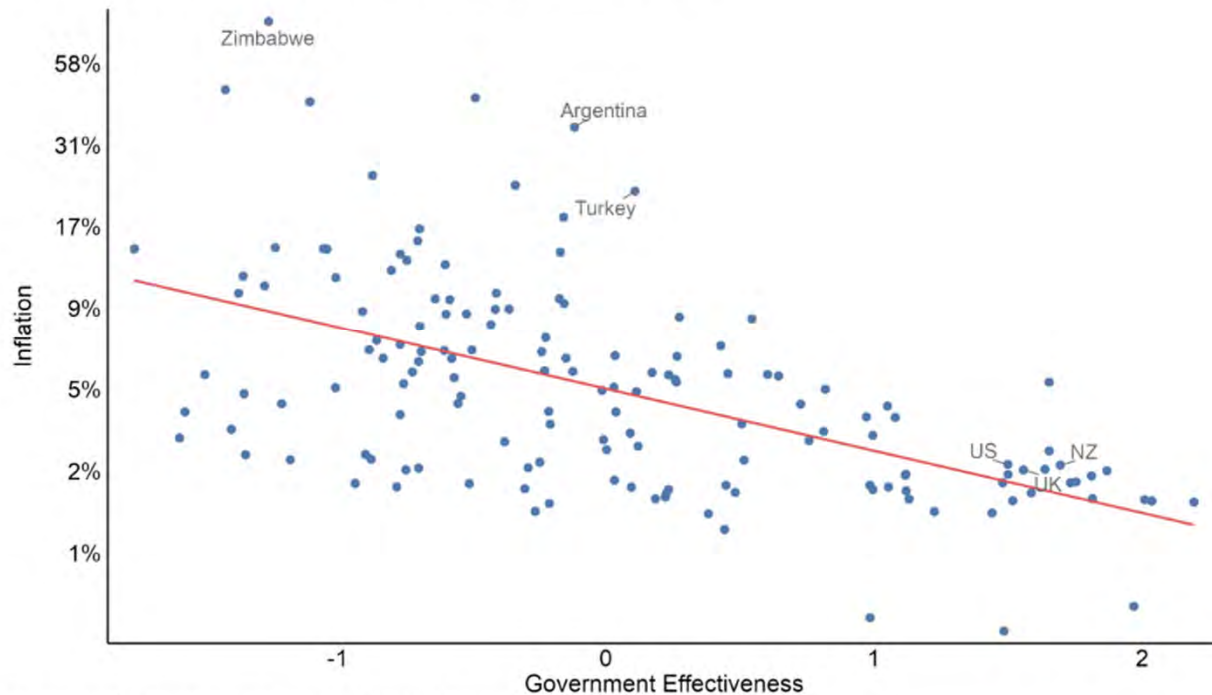


Alternative Interpretations

- 1) Markets are not aware/paying attention
 - Doubtful
- 2) Market 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)

THE IMPACT OF GOVERNMENT EFFECTIVENESS ON INFLATION
CONTROLLING FOR CENTRAL BANK INDEPENDENCE, 2000-2023



Sources: World Bank *World Development Indicators* and *Worldwide Governance Indicators*
Note: Inflation is scaled on the y-axis by an inverse hyperbolic sine function.

Econofact: econofact.org

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