ANNUAL MEETINGS
2017 | WASHINGTON DC
WORLD BANK GROUP
INTERNATIONAL MONETARY FUND

Governor's Statement No. 17

October 13, 2017

Statement by the Hon. **CARLOS FERNANDEZ,**
Governor of the Fund for **PARAGUAY**

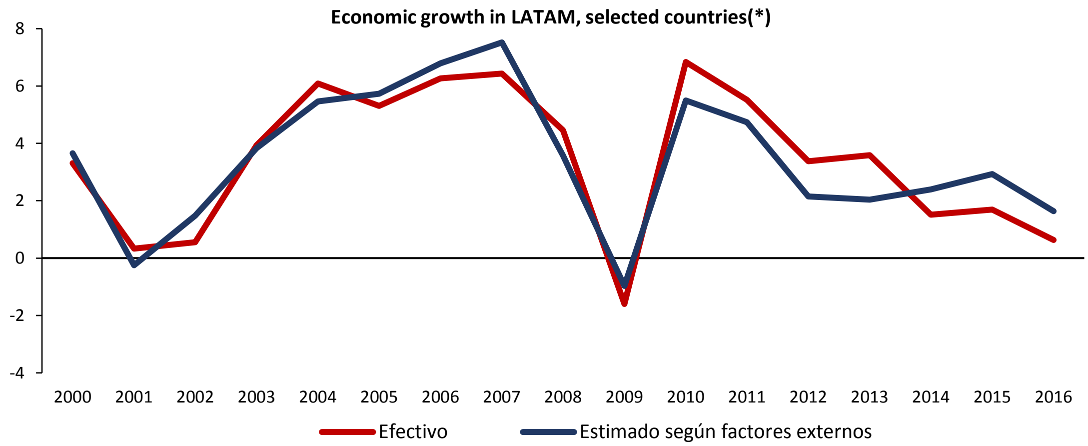
Statement by the Hon. Carlos Fernandez,
Governor of the Fund for Paraguay

The four Cs of Central Banking

The economic activity in Latin America and the Caribbean has been losing strength since the commodities boom reached a peak. After a decade of average growth of 4.6% (5.3% disregarding 2009 downfall), the six largest economies of the region experienced a significant slowdown starting in 2014, with an average growth a 1.3%. Whereas there are specific domestic factors of each economy that have contributed to this deceleration, less favorable external conditions in the recent years explain much of it. A study conducted by the Research Department of *Banco Itaú* in Brazil identifies three external factors – global growth, China's growth and the country risk for emerging economies- as the main determinants of the dynamics of these economies during the "golden years" of growth. These three factors explain both, the economic performance at an aggregate level as well as the particular growth path of Argentina, Brazil, Chile, Colombia, Peru and Mexico.

The term "*new normal*" has become quite frequent in recent discussions with colleagues and academics. It refers to the new international economic scenario that our economies are currently facing. For the emerging economies, this *new normal* encompasses external factors –such as lower commodities prices and stricter financial conditions- that are beyond the control of policymakers. Understanding that the international environment no longer contributes to growth as in the "golden years", domestic policies come to be more relevant to avoid the deepening of the problems generated by external factors.

Under this new global state of affairs, Central Banks policymaking becomes particularly complex and challenging. The unfavorable dynamic of the external factors aforementioned has generated more uncertainty to consumers and producers. Furthermore, the recent world financial crisis has eroded the confidence in our understanding of both, economic science and the proper way to implement the monetary policy under the current circumstances. Nevertheless, it is imperative that at this conjuncture the Central Banks of take into account the following elements: communication, calculation, coordination and commitment. These would be, "***The Four Cs"*** that the monetary authorities should seriously consider in the ***"New Normal".***



(*): Arithmetic mean of the growth in de Argentina, Brazil, Chile, Colombia, México and Peru.
The estimated model is based on Banco Itaú's report "Slowdown in Latin-American: the role of external factors"
Source: International Monetary Fund and Banco Itaú.

A good **COMMUNICATION** is the first instrument that a central banker ought to use at all times, especially in times of high uncertainty. Frequently, it seems like central bankers speak Chinese in London, Spanish in Beijing and English in Brasilia. Generally, we are not good at communicating, which is vital in world where uncertainty prevails and conditions decision making by the economic agents. Clear communication is fundamental not only for an investment fund professional or an economic analyst, but for anyone who ought to take an economic or financial decision, regardless of its size. It is the Central Bank's responsibility to use all the necessary means to explain in a clear and simple manner the current and expected scenario of the economy, to announce the tools we have available to face new challenges, to explain the main risks we are facing and the events that are beyond our control that we must learn to adapt to. In these times, Central Banks must have the ability to state clearly their policies: what they are doing (and why) and what they are not doing (and why not).

Regardless of it being from an advanced or developing country, the Central Bank must operate in a changing environment which has turned more complex. At the current conjuncture, for a right implementation of its policies, monetary authorities demand accurate information regarding the potential output of the economy. This requires a precise **CALCULATION** of the real growth capacity of the economy. Quantifying this variable is not trivial and, given that there has been a change in external conditions, central banks (and the economic authorities in general) should acknowledge this. Likewise, it is important to explain to the public that this number might be below the estimated during periods of commodities boom and more favorable financial conditions. Policymakers should be careful to avoid making erroneous judgements about the conditions of the economy and taking decisions under the premise that the economy is below its potential level.

The monetary policy cannot maintain an economy stable and growing on its own. It needs the support of the fiscal policy. A Minister of Finance can be the best friend or the worst enemy of a central banker. This is why, the **COORDINATION** between monetary and fiscal policy is a necessary condition to maintain the macroeconomic stability in the medium term. The effectiveness of a central bank is conditioned by the actions of the Ministry of Finance. The Latin-American experience has taught us that the central banks struggle to reduce inflation when the fiscal accounts are not balanced (this is, when the fiscal deficits are high and persistent or when the public debt rises at an unsustainable rate). For this reason, fiscal discipline is vital to ensure the achievement of the central bank objectives and requires not only a permanent dialog among between both institutions, but also that both aim the same objective in the short and medium term.

Finally, almost ten years after the great global financial crisis, it is fundamental that central banks permanently reaffirm their **COMMITMENT** with price stability. Studies demonstrate that the best contribution that a central bank can make to society is to maintain inflation low, stable and predictable. This is one of the reasons why a central bank is granted independence: so that is scope of attention be to ensure price stability, given that this contributes to the construction of the largest asset of a central bank: its credibility. If the people are convinced that the central bank will take the necessary actions to maintain the price stability, those actions will be even more effective. The degree of commitment before society largely determines the degree of success or failure of the work of a central banker.

In this moment of low growth, it is crucial to acknowledge that the current economic weakness in many of our countries has structural and not cyclical roots, so it requires solutions of the same nature. Therefore, the medium-term growth challenge cannot be assumed from the monetary policy (neither from the fiscal!), since this strategy will not be sustainable over time.

These four Cs are not intended to encompass all the aspects that monetary policy makers must consider, but it will undoubtedly be important to take them into account under the *new normal* that developing economies are currently facing. They reflect the lessons that we have learnt in different junctures but are applicable to the new global scenario. The economic and financial conditions are less favorable than we were accustomed and they bring new risks. This implies that central bankers –as wardens of the macroeconomic stability- must remain permanently alert utilizing in a flexible and in the best possible way the set of tools available to fulfill the mandate of society.