New challenges for the central banks

The Silicon Valley Bank (SVB) intervention and the shock wave it triggered throughout the rest of the international financial system has been yet another obstacle on the path towards the normalisation of the international economic cycle. Moreover, however, it can be seen as a test for the central banks' dual mandate that was consolidated after the 2008 financial crisis, when the traditional inflation target was supplemented with the task of ensuring financial stability, which is a prerequisite for keeping prices under control by promoting a proper functioning of the transmission channel for monetary policy. Under ordinary circumstances, this expanded approach to the role of monetary policy does not usually pose a problem for central banks, since even the instruments used to achieve each of the goals are different: interest rates for inflation, versus supervision, regulation and liquidity facilities for financial stability.

But a cumulative rise of nearly 400 bps in global interest rates in the space of less than a year, following a decade of near-zero or negative yields, marks a regime change that can test the central banks' dual mandate. This is especially the case when there are still no clear signs of a change of trend in the price dynamics. What should be done in such a situation? Should the central banks stick to the pre-announced roadmap, pause along the way, or even cut interest rates if tensions escalate? For the moment – and quite rightly, in our opinion – they have decided to follow through with the rate hikes they had already announced (25 bps by the Fed and 50 bps in the case of the ECB), while simultaneously expanding the windows for supplying liquidity to the banks. A different type of decision would have increased distrust and, therefore, the risk of contagion. For the rest of the year, decisions will be taken with greater flexibility, depending on how the price and economic activity indicators evolve and taking into account the extent to which the events in March influence this evolution through three key channels: confidence, financial conditions and credit supply.

The market's initial assessment was that the disinflationary effect caused by the financial stress would allow the central banks to be somewhat less aggressive in the coming months. This led to a significant reduction in interest rate expectations, even leading to the anticipation of rate cuts in the US beginning in the summer, in the midst of a risk-off process. However, it is still too early to try to estimate what effects this episode will have on the business cycle and inflation given that, while we wait to see how things pan out in the credit channel, the rise in credit risk premiums and volatility indicators has not been accompanied by a deterioration in expectations. This demonstrates that the rapid response from the central banks has helped to restore some tranquillity.

As is often the case in the final moments of monetary tightening processes, it is logical that financial stability takes on a more important role in the central banks' reaction function. However, in view of accidents such as that of SVB, the focus should be on the detection (and correction) of particularly fragile business models. Focus should also be placed on increasing the coordination of regulation and supervision at the global level in order to avoid distortions such as those caused by the Credit Suisse intervention in the functioning of important segments of the fixed-income markets (AT1). What seems clear is that we are once again facing a year of high volatility in the markets, since in just a single quarter we have seen three changes of trend in the behaviour of global financial assets. Not only that, but this is also a year in which the demanding mandate of the central banks will once again be put to the test.

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