The BCRP Centenary Conference jointly hosted with the BIS

Welcome Speech

24-25 March 2022

I am delighted to welcome you all to this Conference for the centennial of central banking in Peru. First of all, I would like to thank the Bank for International Settlements for agreeing to co-host this event and for committing its organizational resources to it and helping to disseminate it to a global audience. Alexandre, thank you very much for your support. Please convey to Mr. Carstens and the BIS teams our gratitude for their contribution in making this conference become a reality. Your kind assistance confirms the close relationship with the BIS ever since the Central Reserve Bank of Peru intensified its participation in BIS activities since the 1990s, and even more so when it became a formal member in 2011.

Three decades ago, Peru's monetary performance experienced a radical change in direction, after decades of policy and institutional misdirection that climaxed into one of history's hyperinflation cases studies. Since February 1997, inflation has remained in single digits (for the first time since 1921-1940). Since the beginning of the century, under an inflation targeting arrangement, Peru's average inflation was 2.7%, the lowest among LATAM countries issuing their own currencies. In particular, monetary stability contributed critically to promoting growth, after decades of stagnation and recession. In 2019 Peru reached a milestone of 21 years of expansion, the longest period of consecutive growth in 100 years.

How did this happen? It was the result of a long, winding process. Here we find a first powerful reason for putting together this event: revisiting our journey as a central bank over the last century through countless challenges, both domestic and external, provides a unique opportunity for reflecting on the progress made, the lessons learned, and the pending agenda; and, crucially, for further communicating the benefits of sound central banking to the public. In recent times we have confirmed that the latter (that is, mustering consensus around the importance of good central banking practices for economic stability) pays off in terms of securing the central bank's mandate.

The current Central Reserve Bank of Peru was founded in 1922 as the Reserve Bank of Peru. The first central banks in Latin America were established in the 1920s, following an international consensus that countries needed to have a central bank, mostly aiming to prevent volatile inflation under a gold standard. Within the initial wave of Latin American central banks, founded following the model of the U.S. Fed, the first one in the region was the Reserve Bank of Peru, followed shortly afterwards by the central banks of Colombia, Chile, and Mexico.

Peru's first central bank was assigned the jobs of enforcing the monopoly of currency issuance and ensuring adequate means of payment to keep the economy going; that is, a set of functions, but not actual policy objectives. In this context, from the outset there were tensions between the central bank and the government arising from the latter's pressure for financing. This trend would mark the coming decades but, since its very inception, the central bank voiced the need for macroeconomic discipline to promote stability and growth. The central bank documents from that time show the extent to which the first boards of directors were concerned not only with financial stability (as most of them were important local bankers) but, importantly, also with fiscal sustainability, reflecting the importance they attached to sound fundamentals.

The Kemmerer mission, which brought about the creation of the current Central Reserve Bank of Peru in 1931, is regarded as a landmark in our institutional life. Although the gold standard he championed was overrun only months after being enacted, it was a first attempt to formally (if not explicitly) introduce some level of independence, where the central bank was endowed with operational autonomy due to the policy limitations imposed by the gold standard. Importantly, a feature that runs through all documents left by the Kemmerer mission is the need to limit political pressures to finance government operations and emphasize fiscal discipline as a necessary condition for viable monetary policy. However, in an international context marked by the Great Depression and a domestic landscape plagued by political instability, maintaining the gold standard proved unsustainable and Peru, like the rest of Latin America and the world, abandoned this monetary system. At this point, central banks acquired greater discretion to implement monetary policy; and Peru and other countries in the region entered several decades of fiscal dominance, where financing the public sector became a considerable (and often the most important) source of monetary expansion. Especially under the umbrella of "developmental" policies, central banks were burdened with multiple objectives, including promoting growth. It would not be until much later, in the wake of the 1980s hyperinflation episode, that Peru and other Latin American countries finally granted central banks the necessary political and operational independence to focus on controlling inflation, as a condition for recovery and growth. As part of this break with the past, government financing, the main historical source of inflation, was restricted and even banned.

Thus, the turning point for monetary policy that took place in the 1990s was the result of lessons learned the hard way. However, when the time came, the central bank was prepared to face up to the new developments: all along the bank had developed mechanisms to build its human capital by recruiting and promoting its staff based on merit. The central bank's capacity building model has had rippling effects across the public sector; has become a standard for institutional excellence in Peru; and continues to improve in tune with evolving conditions relevant to the bank's work. This autonomous and technically-oriented central bank set out to adopt a new toolkit suitable for fulfilling its new mandate. As inflation declined to single digits in the late 1990s and early 2000s, Brazil, Chile, Colombia, Mexico, and Peru (known as the LA5) introduced inflation targeting to replace exchange rate and monetary targeting, following the lead of some advanced economies like Australia, Canada, New Zealand, and the UK.

Crucially, successful inflation targeting implementation was instrumental in materializing perhaps the central bank's most valuable asset: the credibility of monetary policy, which strengthened over time as the central bank fulfilled its mandate and inflation remained most of the time within the target range. Credibility has a "virtuous circle" effect on the effectiveness of monetary policy, as market participants tend to align their inflation expectations with central bank targets. Anchoring expectations may be taken for granted now, but it took many years to put firmly in place. Most important of all, as the central bank has been able to deliver on its commitments in the benefit of the public, a consensus has emerged about the central bank's credibility; and the tenet of central bank independence has been maintained through successive administrations, some of which initially ran on a populist agenda.

At the same time, there were further lessons to be learnt on the fly, as several rounds of financial crises hit the global economies while Peru and other countries were implementing these improvements. The 1998 Russian crisis hit Peru particularly hard, and the main lessons to take on board were keeping an eye on the financial cycle, including by reinforcing financial legislation and empowering supervisory authorities; and maintaining adequate international reserves as insurance policy against capital reversals. Armed with this experience, by the time the Global Financial Crisis shook the world economy, instead of the chronic foreign exchange shortages of the past, the central bank had built solid buffers; and was able to weather the reversal of capital inflows and contribute to counter deflationary pressures. At the same time, the Global Financial Crisis ushered in yet another shift, this time towards unconventional monetary policies in major economies and an emphasis on macroprudential policies (within a "flexible inflation targeting" framework) in emerging economies. The most recent milestone in this continuous process of learning and adapting to evolving global conditions is, of course, the COVID-19 pandemic, where authorities all over the world had to take action in extraordinary ways, including through a massive participation of central banks. The challenges left by the health crisis and the outlook for central banks in a post-pandemic world will be the subject of the discussions today and tomorrow. The work ahead is daunting in terms of dealing with the aftermath of the pandemic and considering the possibility to take in new technological developments, and therefore I look forward to an enlightening exchange of ideas from our distinguished group of guests. We are honored to have them with us in this centennial celebration.

I thank you very much for attending this event.