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## Welcoming remarks: Central Reserve Bank of Peru Centenary Conference

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I would like to join Governor Velarde in welcoming you to the centenary conference of the Central Reserve Bank of Peru, or BCRP. We are delighted to team up with our Peruvian colleagues in organising this event.

Let me set the scene for the conference by laying out some of the key lessons that I take away after reflecting on 100 years of central banking in the Americas.

First, there is no doubt that unsustainable public finances undermine price stability. We saw it in Peru. Even though the original law of the central bank expressly prohibited direct lending to the government, the BCRP soon found itself under pressure to do just that. Monetary financing was behind several episodes of high inflation, the most recent and devastating of which was the hyperinflation of the late 1980s and 1990s.

Inflation did not rise because of central bank inaction. On the contrary, the central bank took many measures to reduce inflation. But, as long as the underlying problem – unsustainable fiscal positions – was not solved, these measures had only a temporary impact on inflation.

However, in the early 1990s the narrative changed. In 1993, the BCRP gained independence, and the government embarked on a programme of fiscal consolidation. This time the disinflation did last. Inflation fell, supported by fiscal reforms, followed by an exemplary central bank track record.

The second lesson is the need for central bank independence. Even before 1993, the BCRP did try to tighten policy when faced with high inflation, but as soon as the next recession loomed, it was unable to resist calls for renewed advances to the government.

The third lesson is that independence must come with accountability. Central banks must convince the public that they will do everything necessary to achieve their objectives. They must explain what they are doing and why they are doing it. And they must do so in a language that is understood by the public.

The fourth and final lesson is that exchange rates need to be flexible to serve as shock absorbers. Only flexible exchange rates allow central banks to concentrate on their price



stability objective. Flexible exchange rates also increase financial resilience, for instance by reducing the incentives for borrowing in foreign currency.

Flexibility alone may not be enough. Sharp exchange rate movements continue to be an important source of instability in our region. But rather than fixing exchange rates – which is ultimately unsustainable – central banks should focus on building resilience, reducing volatility and smoothing the adjustment. To do this, they require additional policy tools on top of interest rates. Here the Peruvian experience has a lot to offer. The BCRP was one of the first central banks to use derivatives to reduce exchange rate volatility and to differentiate reserve requirements to reduce dollarisation. Reducing excess volatility goes a long way towards ensuring that exchange rates absorb rather than amplify shocks.

The central banking model in place since the 1990s in Peru and many other of the region's countries has been successful thus far. But success cannot be taken for granted. The toolkit has to keep up with changes in the economy, financial markets and external factors.

Perhaps we need to go even further. Today even the nature of money is changing. Cryptoassets, in particular stablecoins, show that there is a demand for money in electronic form. Central banks, the BCRP included, are therefore working hard to explore central bank-operated alternatives. I strongly believe that a central bank-operated digital currency will be much more trustworthy than one supplied by private agents, whose incentives may not be well aligned with those of the public.

Before concluding, let me tell you that we at the BIS Americas Office in Mexico City are celebrating our 20th anniversary this year. Over those two decades, we have grown in both size and our number of activities. Our Consultative Council for the Americas, or CCA, brings together the Governors of the eight BIS members in the region and has become the main forum for discussion among central banks in the Americas. Under the CCA's umbrella we have established several technical groups. I am pleased to report that the BCRP plays an active role in all of them. Last but not least, in 2020 we opened a trading floor in Mexico City, which allows the BIS to offer banking services around the clock.

Thank you for joining the conference. I look forward to the speakers' presentations and our discussion.