The crucial role of financial stability in a central bank's policy strategy framework – speech by Randy Kroszner

Given at the European Central Bank

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Speech

While I'm absolutely delighted to be invited to speak at this conference, some might question the wisdom of the organizers for inviting me. I joined the Federal Reserve as a Governor in 2006 and the Global Financial Crisis (GFC) soon erupted. I joined as a Member of the President's Council of Economic Advisors only months before the tragedy of 9/11. My 'brief' stay in London in late 2019 and 2020 as Deputy Dean of the University of Chicago's Booth School of Business to build and open our expanded London campus was significantly prolonged by the outbreak of Covid-19. And Silicon Valley Bank collapsed as I joined the Bank of England's Financial Policy Committee (FPC) in March 2023 for my first set of meetings.

It's thus with some trepidation that I stand before you this evening to talk about financial stability within the central bank policy framework. "Après moi …"

I've witnessed economic and financial shocks since the GFC developments not only as a member of the FPC but also chair of the Federal Research Advisory Committee to the Office of Financial Research at the US Treasury for the last seven years as well as a member of the Academic Advisory Committee of the Chicago Fed for the last decade. More recently, we at the FPC have expressed concerns about the deterioration in the global risk environment and increased uncertainty.[1]

The core theme of my remarks tonight is very simple – almost trivial: central bank policymakers should be actively cognisant of what each other are up to. For example, macroprudential policymakers should care about monetary policy and monetary policymakers should care about financial stability – because an awareness and understanding of one enhances the effectiveness of the other.[2] Much recent research undergirds this connection, both in theory and empirically and the Bank's established way of working provides a good example of how this can be implemented in practice.[3]

Before going further – to avoid eye rolling, gasps of "oh no, not again," and excuses to nap after dinner, I want to be clear that I am not trying to revive the old debate on whether monetary policy should be used for financial stability purposes, bursting bubbles, etc.[4] Instead, my reasoning builds on the argument that Federal Reserve Chair Powell made

[1] See, for example, **Financial Policy Committee 2025 Q1 Record.**
[2] I want to be clear that my remarks should not in any way be construed as commenting on the stance of monetary policy but on the broader policy strategy framework that provides a foundation for central bank actions and communications.
[3] The Bank's approach has evolved since Charlie Bean set out a compelling case for the deployment of macroprudential instruments, rather than monetary policy, to enhance financial stability. It is eloquently outlined in a speech by Sarah Breeden in 2023 where she demonstrated how monetary and financial stability are separate but complementary, and inherently intertwined – two sides of the same coin.
[4] See, for example, White (2020), 'International Financial Regulation: Why it Still Falls Short'.

last month that a central bank's policy strategy framework needs to "be robust to a broad range of conditions [and be] robust to a wide range of economic environments and developments".[5]

The true test of the robustness of any policy strategy framework is how it can provide a useful guidance not only in normal times but times of stress and turbulence.

The GFC, Covid, as well as recent events have underlined the importance of understanding the interaction between the different aspects of a central bank's policy strategy framework. In a world of greater volatility, more frequent and persistent supply shocks, and increased uncertainty and risks I would argue that it is particularly important financial stability is explicitly and consistently integrated into a central bank's overall strategy, tools, and communications. As I will argue, such an integration will help ensure the tools are in place to expedite any responses to crises, when they do occur, while also helping to ensure markets can quickly and appropriately understand and interpret crisis responses a central bank has taken and their impact on the macroeconomy.

Given all this, I am pleased to say that the interaction between financial stability and monetary policy strategy is a priority research topic for the Bank of England, with its **Agenda for Research** over the next three years explicitly stating how "it is important to understand how various central bank policy tools interact to influence the macroeconomic outcomes and financial stability risks". This is very welcome.[6]

The remainder of my remarks will focus on the elements of how best to incorporate financial stability into a central bank's policy strategy framework. In a world of new global challenges, I argue that a robust policy framework needs to incorporate three key elements:

1) Identifying how the central bank will provide liquidity to deal with a wide range of shocks;
2) Undertaking stress testing and scenario analysis to understand how shocks affect the effectiveness of policy transmission; and
3) Developing a communications strategy that allows for a clear delineation of motivations for financial stability actions.

Before elaborating these elements, I will describe how the economic and financial system has evolved to involve greater financial stability risks and outline a simple framework for

[5] Jerome Powell (2025), **Opening Remarks At the Second Thomas Laubach Research Conference**, p.2 and 6.
[6] Aikman et al (2023), for example, argue that monetary and macroprudential policies interact with each other in a way that suggests there are benefits to be gained from a having both levers in a central bank toolkit.

understanding the interaction between a central bank's overall policy strategy and those risks.

I will emphasise how the changing economic and financial environment and new insights from research into the interaction between different aspects of a central bank's policy strategy framework provide the foundation for the three elements of a robust central bank policy framework.

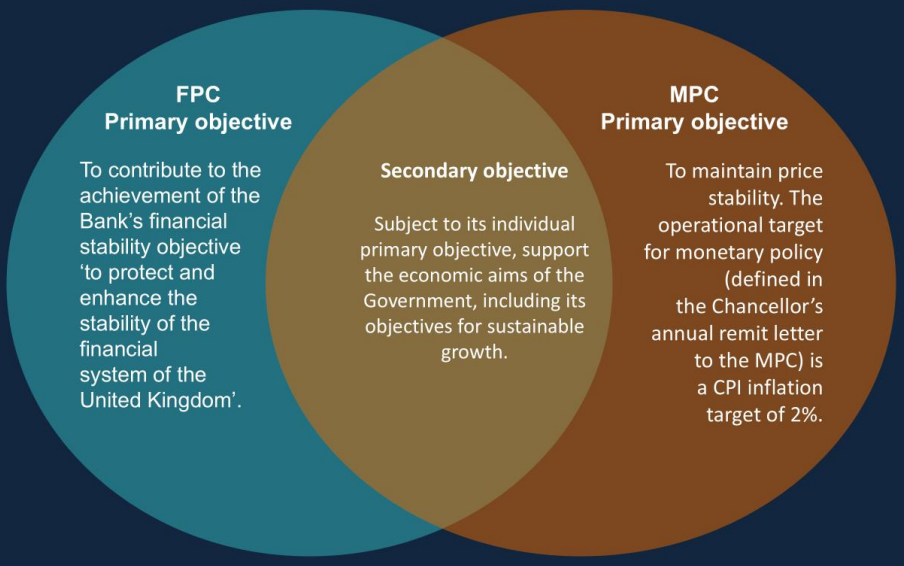
As Sarah Breeden has said, monetary policy and financial stability are "two sides of the same coin",[7] and I will first consider how the Bank of England has managed (successfully in my view) to operationalise that, as I believe there are helpful lessons to be drawn from its approach.

The Bank's way of working

The Bank was given its specific statutory objective in relation to financial stability following the GFC. The arrangements were modelled on the monetary policy set up, encompassing a primary objective to "protect and enhance" UK financial stability, and a secondary objective to support the government's economic policy. (**Figure 1**). The individual objectives of both committees are typically complementary and both ultimately have the aim of underpinning economic growth and prosperity.

[7] Sarah Breeden (March 2023), **Two sides of the same coin – delivering monetary and financial stability timelessly.**

Figure 1: The FPC and MPC at the Bank of England



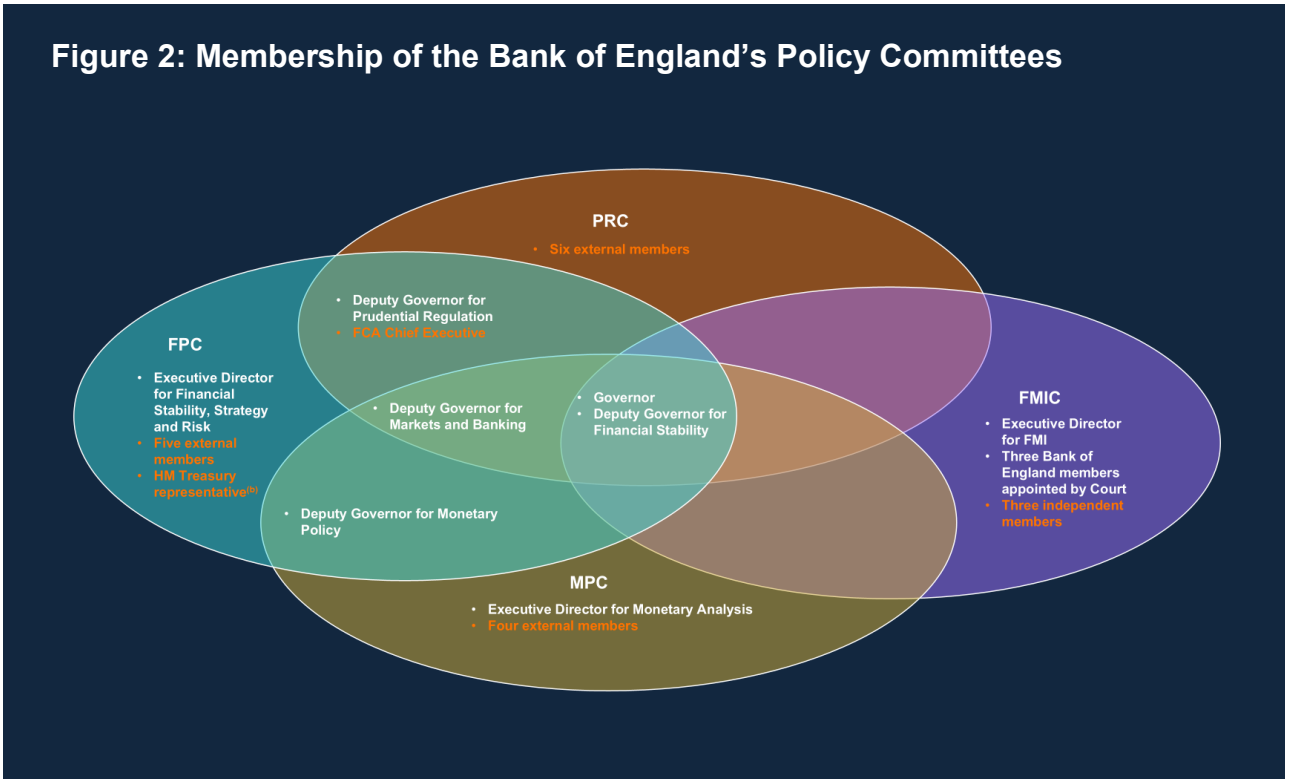
Source: Bank of England, Quarterly Bulletin (2024), **Financial stability at the Bank of England**

Since the financial stability objective was given to the Bank of England, its interaction with the monetary policy function has evolved. There is actually nothing in the statute itself that explains how the Bank's responsibilities in relation to monetary policy and financial stability are to interact. But HM Treasury has tended to use its remit letters to emphasise coordination between monetary policy and macroprudential policy.[8]

For example, the most recent MPC remit letter states that: "Circumstances may also arise in which attempts to keep inflation at the inflation target could exacerbate the development of imbalances that the Financial Policy Committee may judge to represent a potential risk to financial stability. The Financial Policy Committee's macroprudential tools are the first line of defence against such risks, but in these circumstances the Monetary Policy Committee may wish to allow inflation to deviate from the target temporarily, consistent with its need to have regard to the policy actions of the Financial Policy Committee."[9]

In practical terms, coordination is also facilitated by the overlap of MPC and FPC membership (**Figure 2**), and the MPC is also expected to "reflect, in any statements on its decisions, the minutes of its meetings and its Monetary Policy Reports, how it has had regard to the policy actions of the FPC".

[8] **The Bank of England's statutory monetary policy objectives: a historical and legal account**, Staff working paper, January 2025.
[9] **Monetary policy remit 2024**, November 2024.



Source: Bank of England, Quarterly Bulletin (2025), **The contribution of the Financial Policy Committee to UK financial stability**
(a) Members shown in orange are not part of the Bank's executive team.
(b) The HM Treasury representative on the FPC is a non-voting member.

There are several formal and informal arrangements that enable information to flow freely between the two committees. The common chair of the two committees and their overlapping membership helps to ensure an understanding of the key issues one Committee is facing in the discussions of the other, in an informal way. When appropriate, the overlapping members provide live updates during the respective policy rounds.

Members of both Committees have full access to all relevant briefing materials produced by Bank of England staff, for both the MPC and FPC, and it is routine to for them to be invited to attend briefings for the other committee.

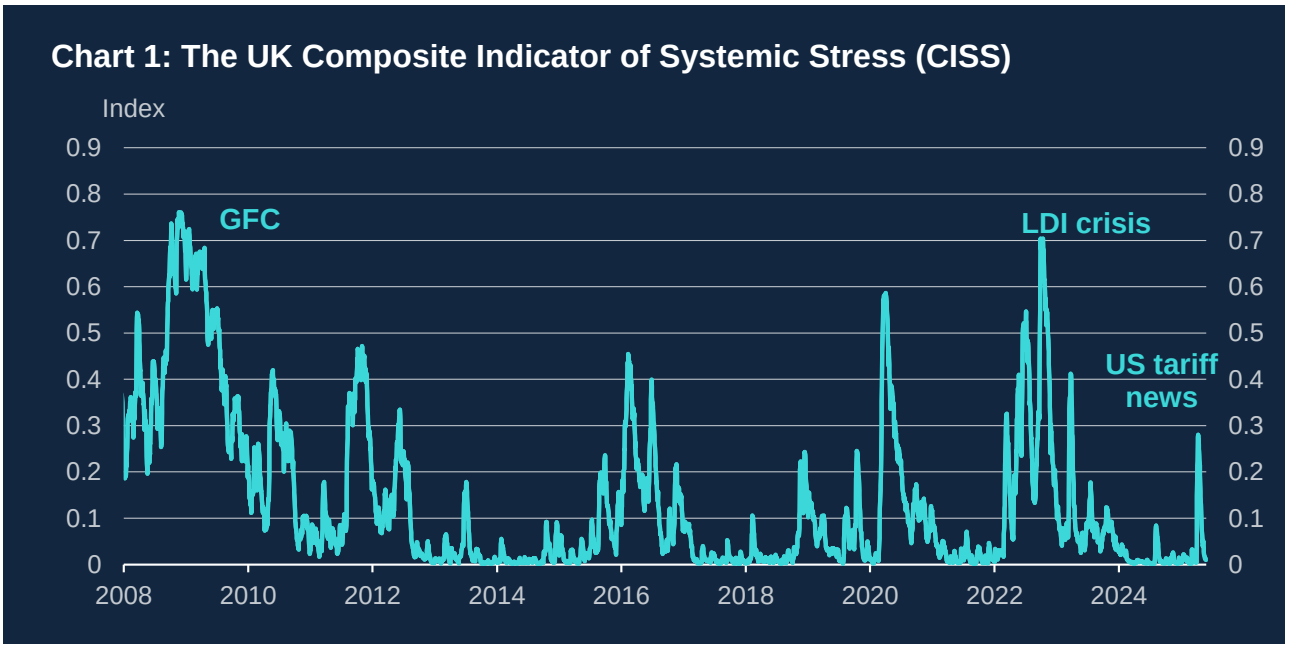
The members of the FPC who are not on the MPC also get briefed after each MPC forecast round. This is important, because the FPC uses the MPC's central projections for macroeconomic variables as the baseline for its own assessment of risks to the financial system stemming from the economic outlook.

Similarly, members of the MPC who are not on the FPC get briefed on the FPC's discussions. Again, this matters, because the MPC conditions its forecasts on relevant policy actions that the FPC has announced. One channel through which this takes place is through the MPC's assessment of the cost and availability of credit, and of the impact that changes in the availability of credit have on economic activity and inflation, for example, if the FPC had reduced the UK countercyclical capital buffer to support lending.

There are also joint meetings of shared interest, in order to ensure a shared understanding of the financial system and how it is affecting the economy, in which they can jointly steer the path for staff analysis and long-term research.

Financial stability and central bank policy strategy in an uncertain world

As the FPC warned in April, the probability of adverse events, and the potential severity of their impact has risen.[10] The potential for global economic shocks originating from rising geopolitical risks, trade policy, and global sovereign debt vulnerabilities is front and centre of financial stability policymakers' minds. The UK Composite Indicator of Systemic Stress (CISS) showed an uptick earlier this year following the US announcement on trade tariffs (**Chart 1**).



Sources: European Central Bank

These vulnerabilities could be exacerbated by a reduction in global co-operation in tackling shocks, which could reduce the resilience of the financial system. High public debt levels in major economies could also reduce the capacity of governments to respond to future shocks, while a deterioration in market perceptions around the sustainability of the long-term path of public debt globally may lead to higher rates, increased term premia and market volatility. This arguably means central banks could be on the hook with greater frequency and intensity to respond to challenges in the future.

Running alongside these heightened risks an increasingly global and interconnected financial system, driven by the growth of market-based finance following the global financial crisis as well as, more recently, innovation in technology and artificial

[10] See, for example, **Financial Policy Committee 2025 Q1 Record.**

intelligence.[11] These developments are important to the functioning of the economy, and many bring valuable opportunities to all of us. But they can also create new vulnerabilities that if improperly managed, or if managed without accounting for system-wide dynamics, can create spillovers that can negatively impact the real economy.[12]

At the core of a good macroprudential framework is a need for it to work in good times as well as bad. My argument is that in a world where we are already anticipating more frequent and persistent shocks – as the FPC have set out – then any central bank's overall policy and strategy framework also needs to be robust to the crystallisation of risks and understand what these shocks could mean for monetary policy as well as financial stability.

My view is that it is important to avoid indifference between monetary policy and financial stability, not just because of the implications for financial stability, but rather to ensure the effectiveness of policy transmission more generally. My colleague Sarah Breeden has, for example, described how "an unstable financial system is a problem for monetary policy".[13] A monetary policymaker relies on the financial system for monetary policy to transmit through the economy. It therefore needs a functioning banking and financial system, and it needs markets not to be in disarray.[14] Put simply, a resilient financial system allows monetary policy to do is job.

Impacts on liquidity, as well as interest rates, are key channels through which the decisions of a central bank on both the monetary policy and financial stability side can interact. Temporary and targeted asset purchases in times of stress – like the Bank conducted in 2022, for example, can ease pressure on dealer intermediation, sometimes called the "asset liquidity channel". But there is a trade-off with respect to this asset liquidity channel as large scale of purchases of relatively safe assets might – in some circumstances – worsen liquidity conditions by reducing the supply of assets available for use as repo collateral (see, for example, **Pelizzon et al, 2025**)."[15] In addition, as a central

[11] See, for example: Randy Kroszner (2023) '**Interconnectedness, Innovation and Unintended Consequences'**, Randy Kroszner (2024), '**Balancing the productivity opportunities of financial technology and AI against the potential risks'**; and Jon Hall (2024) '**Monsters in the deep?**'.
[12] See, for example, **Financial Stability in Focus: The FPC's approach to assessing risks in market-based finance** (October 2023) and **Financial Stability in Focus: Artificial intelligence in the financial system** (April 2025).
[13] **Sarah Breeden** (2023).
[14] Similarly, the Federal Reserve's "Statement on Longer-Run Goals and Monetary Policy Strategy" (adopted effective January 24, 2012; as reaffirmed effective January 30, 2024) argues "[S]ustainably achieving maximum employment and price stability depends on a stable financial system. Therefore, the [Federal Open Market] Committee's policy decisions reflect its longer-run goals, its medium-term outlook, and its assessments of the balance of risks, including risks to the financial system that could impede the attainment of the Committee's goals."
[15] For a further discussion of the flow effects from asset purchases on yields see, for example, Du et al (2024) and Waller (2024). In the latest BoE annual BEAR conference, Annette Vissing-Jorgensen and Isabel Schnabel, two of the leading figures in the field, highlighted the importance of considering the 'convenience yield' differential across assets to avoid unintended financial consequences (slides and recordings of their

bank reduces the size of its balance sheet, a “funding liquidity channel” could arise as financial markets and institutions need to absorb more securities in an environment in which interest rates may be rising.[16,17,18]

The development and growth of non-bank financial institutions (NBFIs) also may increase the pressure on central banks to act in times of financial stability stress. The liquidity supplied by asset purchases may be particularly important for financial stability in the presence of a large non-bank sector. Vissing-Jorgenson (2021) for example, emphasise how the effectiveness and necessity of large-scale asset purchases in March 2020 was precisely because so many non-banks were involved.[19] This is where the growth of NBFIs since the global financial crisis is again of particular importance (**Chart 2**). Jeremy Stein famously said that “monetary policy gets in all the cracks.” In a world where some of the ‘cracks’ – or the fragilities within the financial system – are arguably becoming less visible and more difficult to observe due to the growth of NBFIs, the central banker’s job is potentially more challenging.

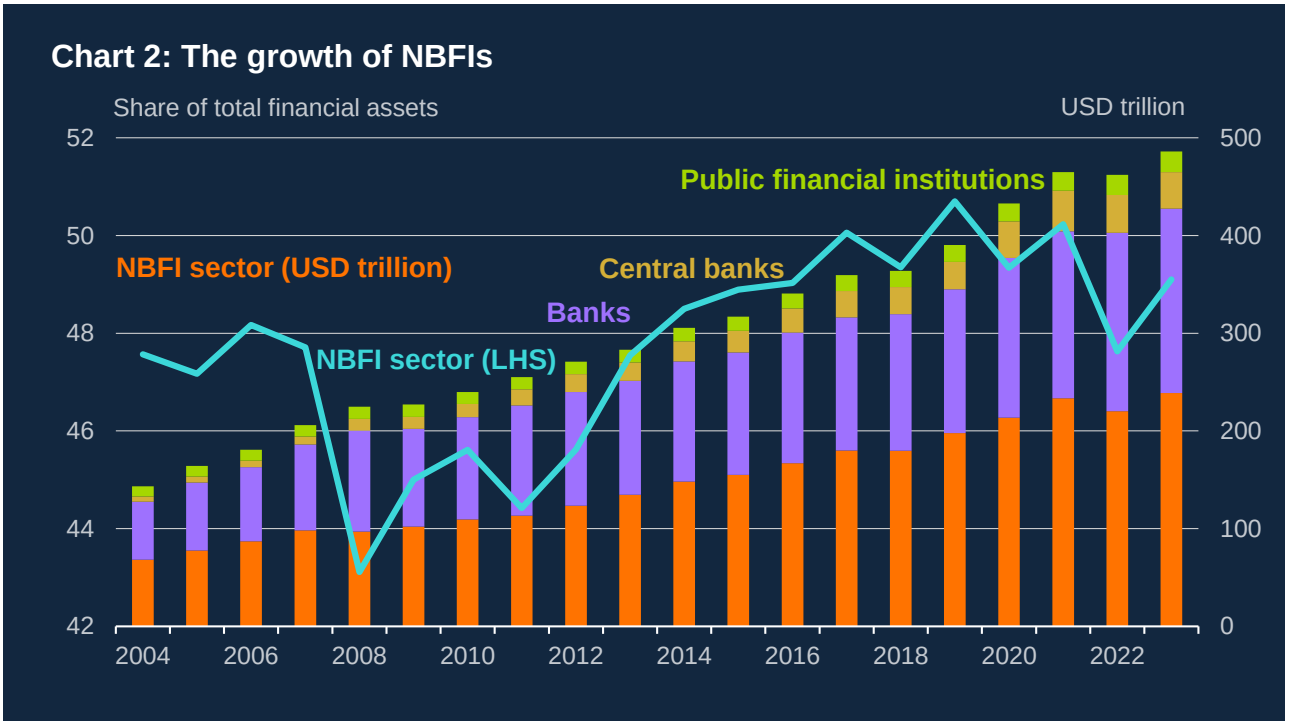
presentations can be found **here**). Further details of the role of QE and QT on liquidity are discussed in Smith and Valcarcel (2024) and **Kaminska et al (2025)**.

[16] The distribution of reserves, as well as money market frictions can lead to heterogenous effects across commercial banks. For example, Kumhof and Salgado-Moreno (2024) develop a New Keynesian model to investigate the interactions between QE/QT with interest rate policy and their transmission to the real economy via the reserve and interbank market, in a model with a rich financial system that incorporates heterogenous banks as well as non-bank financial institutions.

[17] Acharya et al (2023) argue that central bank liquidity expansions lead to financial stability weakness when the central bank tries to remove liquidity from the system. They show, using US data, that commercial banks issued more demand and less time deposits during QE but that they did not reduce these claims on liquid liabilities during QT eliciting a trade-off between monetary policy and financial stability.

[18] Christensen and Krogstrup (2019) show that liquidity effects from QE arising from the liability side of the central bank are significant and independent from the standard portfolio rebalance effects using an event study approach that exploits the unique set-up of LSAPs by the Swiss National Bank in 2011.

[19] Vissing-Jorgenson (2021), The Treasury Market in Spring 2020 and the Response of the Federal Reserve, (2021). This paper also references Liang and Parkinson (2020) paper proposing the permanent removal of central bank reserves from the supplementary leverage ratio. This is an ongoing debate in the US, where an exclusion for US Treasuries is also under discussion.



Source: Financial Stability Board, Global Monitoring Report on Non -Bank Financial Intermediation 2024

And when policymakers do act it will be crucial to draw a distinction between what is a monetary policy action and what has been done on financial stability grounds.

A key example of how this works in practice – which illustrates what I think the Bank of England has got right in this respect – was the LDI episode of Autumn 2022.

When this kicked off, the FPC was briefed on the market dysfunction and noted the risk to financial stability. The Committee recommended that action be taken to address it and welcomed the Bank's plans for temporary and targeted purchases in the gilt market on financial stability grounds at an urgent pace. [20] The Bank also took the decision to postpone gilt sales that the MPC had decided to undertake for monetary policy purposes. The MPC was informed of the market operations before they were implemented. The Bank recommenced with the gilt sales associated with quantitative tightening less than a month later.

To me, this sums up the effective way in which the Bank's arrangements between the FPC and MPC work. Primarily, the purpose of the intervention by the Bank was made clear by the FPC's recommendation. It was done explicitly on financial stability grounds. In addition, the intervention was designed in a way that was targeted and, very importantly, temporary. Furthermore, in parallel, action was undertaken – overseen by the FPC – to improve the resilience of the LDI funds so that the purchases could cease without further instability. In

[20] See Bank of England, Quarterly Bulletin (2023), **Financial stability buy/sell tools: a gilt market case study.**

other words, the purchases were necessary but not sufficient: increased resilience was also needed.

As a result, action to support financial stability was able to be taken in a deliberate manner and then ended cleanly, allowing monetary policy and quantitative tightening to resume. Even though it could have been perceived that both committees were pulling in different directions their goals were complementary and the credibility of each was maintained.

Recent research at the Bank is advancing further our way of thinking about this, specifically how central banks can use surgical interventions to contain shocks and, as a result, better navigate potential trade-offs between policy objectives. Bandera and Stevens (2024), for example, build a theoretical model to replicate the 2022 episode. They find that the Bank of England asset purchases successfully addressed market stress without materially affecting the monetary policy stance, and that the temporary nature of the intervention was key to avoiding monetary policy spillovers.[21]

Three implications for a central bank policy strategy framework

Given the above, I think there are three key ways in which a central bank's policy strategy framework should consider both monetary policy and financial stability. The first is **that a robust policy strategy framework needs to take into account how the central bank will provide liquidity to deal with a wide range of shocks.**

Discussion of how central banks provide liquidity to both the bank and non-bank sector during stress has been a key focus of recent years.[22] Last year, Governor Andrew Bailey set out the importance of central bank reserves to delivering on the Bank's mandate of maintaining financial stability and in implementing monetary policy.[23] As the safest and most liquid of financial assets, central bank reserves act as the ultimate safe asset in the system underpinning settlement between participants.

In the immediate aftermath of the Covid pandemic Andrew Hauser highlighted the need for central bank's balance sheets to support both monetary and financial stability by ensuring their toolkits are able to help markets function "well and safely."[24] Since then the

[21] See Nicolò Bandera and Jacob Stevens, Staff Working Paper (April 2024), **Monetary policy consequences of financial stability interventions: assessing the UK LDI crisis and the central bank policy response.**
[22] See, for example, Victoria Saporta (2024), Let's get ready to repo!
[23] Andrew Bailey (May 2024), **The importance of central bank reserves.**
[24] See Andrew Hauser (2021), **Bigger, broader, faster, stronger? How much should tomorrow's central bank balance sheets do – and what should we leave to financial markets? Some principles for good parenting.** See also Liang and Parkinson, Enhancing Liquidity of the US Treasury Market under Stress, December 2020.

market-wide operations and facilities the Bank uses to achieve its monetary policy and financial stability objectives have been evolving.[25]

Table A outlines details of the liquidity facilities offered by the Bank and the Federal Reserve and designed to provide reserves to financial institutions in different circumstances. These can aid in both monetary policy transmission as well as provide liquidity insurance.

One key development in the Bank has been how it provides liquidity to the non-bank sector during stress. Until this year, the Bank provided liquidity to the financial system as a whole via the banking system, under the assumption that banks would onward lend and that liquidity would eventually find its way to the part of the financial system where it was most needed. But when core financial markets are severely dysfunctional, as in 2020, we have seen that banks are not always willing or able to pass on sufficient liquidity sufficiently quickly to NBFIs to meet their demand and avoid a period of financial instability.

The Bank has therefore been working to develop tools to lend to NBFIs directly in times of severe dysfunction in core UK financial markets when financial stability is under threat. The **Contingent NBFI Repo Facility** (CNRF) was opened for applications in January of this year. The purpose of the CNRF is to address future episodes of severe gilt market dysfunction that threaten UK financial stability arising from shocks that temporarily increase non-banks' market-wide demand for liquidity. It does so by lending cash against gilts to participating firms, reducing their need to sell assets and thereby supporting the gilt market, the most core of all UK financial markets given its size, interconnectedness and importance to the system and to financial stability. The facility is open to eligible pension funds, insurance companies and liability-driven investment funds. As Deputy Governor Dave Ramsden has previously set out, these sectors are our initial focus given they have both been significant sellers of gilts in past stress episodes and have higher levels of resilience relative to some other NBFIs.[26] And it will be priced to be expensive when compared to market pricing in normal conditions, but attractive during times of stress.

The CNRF is a contingent facility. It is only available when the Bank judges that gilt market dysfunction is severe enough to threaten financial stability and its lending facilities to banks will not, on their own, eliminate that threat. As Andrew Bailey has previously outlined there is no rationale for standing facilities for non-banks as they do not create money. In contrast, both standing facilities and contingent facilities are available to banks because they do create money, and we need to ensure its singleness (that is the concept

[25] See, for example, Bank of England, Discussion Paper (2024), **Transitioning to a repo-led operating framework.**
[26] See Dave Ramsden (December 2024), **Getting the balance right: ensuring the Bank's balance sheet can support financial stability.**

that all forms of money have an assured equal nominal value) both in normal times and in times of severe market dysfunction and financial instability.[27]

Table A: Liquidity facilities at the Bank of England the Federal Reserve

Type of tool	Bank of England	Federal Reserve
Standing facility	**Short-Term Repo:** A regular market-wide operation aimed at maintaining control of short-term market interest rates. Provides reserves for a one-week term against high quality collateral at Bank Rate. The STR is intended to be used freely by eligible firms to meet their demand for reserves. **Indexed Long-Term Repo:** A regular market-wide operation that provides reserves for a six-month term against a broader range of collateral. Intended to supply the level of reserves necessary to support monetary control and financial stability needs, alongside the STR. The ILTR is intended to be used freely by eligible firms to meet their demand for reserves. **Operational Standing Facilities:** On-demand, bilateral facilities. They support firms in managing liquidity demand shocks, such as payment frictions, by allowing participants to borrow reserves	**Standing Repo Facility:** A backstop in money markets to support the effective implementation and transmission of monetary policy and smooth market functioning. Provides short-term liquidity through overnight repo operations with a specified minimum bid rate and aggregate operation limit. **Overnight Reverse Repurchase Agreement Facility:** A supplementary policy tool to help control the federal funds rate and keep it in the target range set by the FOMC. **The Federal Reserve's discount window:** designed to help banks manage their liquidity risks efficiently and avoid actions that can negatively impact their customers, such as withdrawing credit during times of market stress. The discount window comprises of three programs: • Primary Credit: Available to depository institutions that are in generally sound

[27] See Andrew Bailey, (February 2025), **Are we underestimating changes in financial markets?**

Type of tool	Bank of England	Federal Reserve
	against Level A collateral, or deposit reserves, at a fixed spread to Bank Rate. The OSFs also limit volatility in market interest rates by providing an alternative source of borrowing to the Bank's regular market-wide operations. **Discount window facility:** A bilateral on-demand facility, allowing firms to borrow highly liquid assets (gilts and reserves) for an initial term of up to 30-days on demand, against the full range of collateral. The DWF is 'open for business' and should be used by SMF participants for the purposes of liquidity management.	financial condition and granted on a 'no questions asked' basis. Currently, the primary-credit rate is set at the top of the target range for the federal funds rate. Typically up to 90 days. • Secondary Credit: Short-term liquidity for institutions not eligible for primary credit, usually overnight and at rates above the primary credit rate. **Seasonal Credit:** Available to assist small depository institutions in managing seasonal swings in their balance sheets. The rate for seasonal credit is an average of selected market rates.
Contingent	**Contingent Term Repo Facility:** Activated in response to any actual or prospective market-wide event. Allows the Bank to provide liquidity against the full range of eligible collateral at any time, term, and price. **Contingent Non-Bank Financial Institution Repo Facility (CNRF):** Aimed at addressing any future episodes of severe gilt market dysfunction that threaten UK financial stability. Likely to be	

Type of tool	Bank of England	Federal Reserve
	used in preference to asset purchases where lending is effective in tackling gilt market dysfunction and when the demand for liquidity is outside the reach of the Bank's existing Sterling Monetary Framework (SMF) lending facilities. The CNRF will lend cash to participating insurance companies, pension funds and liability-driven investment funds against UK sovereign debt (gilts) for a short lending term.	

The second element is that **a robust central bank policy framework should recognise the benefits of stress testing and scenario analysis to understand how shocks affect the effectiveness of policy transmission.**

The Bank's approach to stress testing is one which I feel has been mutually beneficial to the FPC, the MPC and indeed the Prudential Regulation Committee (PRC) as well.

The Bank's bank capital stress test, like others, examines the potential impact of a hypothetical adverse scenario on the health of individual institutions or the system as a whole. In doing so, stress tests allow policymakers to assess resilience to a range of adverse shocks to help ensure the system cannot just withstand those shocks, but also continue to support households and businesses if a stress does materialise.

Between 2017 and 2019, and again in 2022 the Bank's ACS stress test included a 'rates up' scenario, where interest rates were assumed to rise sharply. (As an aside, I would mention how this is in contrast to the Federal Reserve's approach in the US, where capital stress test scenarios have generally included cuts to interest rates.)

The rich datasets the Bank's stress tests have generated have allowed policymakers across the Bank – microprudential, macroprudential and monetary policymakers – to better understand the way in which interest rate rises transmit through the financial system.

Indeed, in March 2023, Silicon Valley Bank collapsed in the US and, in the UK, SVB UK went into resolution. This came at the same time as severe stress at several regional banks in the US and there was the potential for a wider loss of confidence in the global banking system and a tightening in financial conditions, including in the UK. Ahead of the MPC's policy decision taken on 22 March, the FPC shared its analysis of the developments in the global financial system with the MPC. The FPC made clear that it judged that the UK banking system remained resilient and was well placed to continue supporting the economy in a wide range of economic scenarios, including in a period of higher interest rates.

The FPC was, in part, able to provide this analysis and reassurance to the MPC because of the ongoing work being done over years to understand the potential financial stability risk to the financial system from rising rates.

Stress testing and scenario analysis may also help provide an insight into the dynamics suggested by Acharya and Rajan (2023). This looked at how the Fed's programme of QE may have driven the growth of deposits, especially uninsured deposits, which helped leave the US financial sector more sensitive to potential liquidity shocks, with lower-capitalised banks most exposed. These liquidity-risk-exposed banks then suffered larger drawdowns and larger stock price declines when the pandemic hit in 2020.[28]

Furthermore, following the Bernanke Review, as the MPC moves towards more scenario analysis, the skills and insights gained from the use of scenarios over recent years – albeit in the FPC's case to analyse tail risks – are likely to help the committee in its deliberations and the advice staff provide to it. Deputy Governor Clare Lombardelli recently discussed how scenarios can help monetary policymakers consider how the economy may differ from a baseline.[29]

And finally, the Bank's **system-wide exploratory scenario** (SWES) the results of which were published last year helped shine a light on how banks would draw on central bank facilities in a stress – either as a precautionary measure or because they assess pricing would be more attractive than the alternatives available in the stress scenario. It also explored how a range of NBFIs would be impacted by a stress and what actions they would take, including how their liquidity would evolve and what actions they would take if faced with shortages. This has provided useful analysis of how banks' use of the Bank's lending facilities in such a scenario would be consistent with the design and motivation behind these tools. It has also helped to ensure that the design of the CNRF will allow the Bank to mitigate liquidity shock and address severe gilt market dysfunction in a way that

[28] Acharya and Rajan (2023) Liquidity Dependence and the Waxing and Waning of Central Bank Balance Sheets.
[29] Clare Lombardelli (May 2025) **What if things are different?.**

limits the risk to public funds, moral hazard and reduces the possibility of unintended spillovers to monetary policy from financial stability interventions.[30]

The third element is that **a robust central bank policy framework should involve a communications strategy that allows for a clear delineation of motivations for financial stability actions.**

A major lesson from the LDI episode was the benefit of transparent communication. It was clear that the intervention was done explicitly on financial stability grounds. In addition, the intervention was designed in a way that was targeted and, very importantly, temporary.

The outbreak of Covid in early 2020 also brough forth interventions in response to disruptions in key financial markets. The Fed, for example, made extremely large-scale purchases of the US Treasury securities to reduce the dysfunction in that market where bid-ask spreads widened significantly and liquidity dried up. I believe that the intervention was appropriate and crucial in stabilising the market and restoring liquidity and confidence in the functioning of the market.[31] A policy strategy framework that allows for a clear distinction between interventions to achieve financial stability goals and monetary policy goals might then have made it more straightforward to communicate that, after the Treasury markets calmed, a reduced pace of asset purchases should not be perceived as tightening of policy.[32] I was pleased therefore to see Jay Powell note that the Fed's review will pay particular attention to the changes implemented in 2020, including the way those changes were interpreted by the public and the importance of "clear communications as complex events unfold".[33]

To further this, it is important to have the framework developed and understood in advance, so that the central bank is not struggling to explain both the complex events and the rationale for why they are taking the steps they are in the midst of a stress event. Pro-actively developing the protocols and framework and articulating that in advance is an important part of effective communication when complex events unfold. In addition, by having worked through various scenarios in advance, it can also expedite the responses by the central bank to a stress event.

Conclusion

It is, I would hope, uncontroversial to say that a central bank's overall policy strategy framework should take account of financial stability and be robust to a wide range of economic and financial environments and developments. Indeed, financial stability is a

[30] See **Contingent NBFI Repo Facility – Explanatory Note 24** (June 2024).
[31] See Darrel Duffie (2023) and Vissing-Jorgenson (2021).
[32] See William English and Brian Sack (2024).
[33] Jerome Powell (May 2025).

pre-requisite for price stability (and vice versa), and together they underpin economic growth and prosperity.[34]

We saw very clearly in the global financial crisis how financial instability can affect the economy directly – it can cause or amplify shocks and lead to loss of jobs, investment and output. That matters to all of us.

Few central banks, however, explicitly and consistently consider how financial stability and monetary policy can interact successfully in practice as part of a central bank's overall strategy framework, including the interaction between financial stability and the transmission mechanism. I believe the way the Bank of England operates – as I've set out – is an effective way to provide a robust policy strategy framework that allows for effective interaction between the FPC and MPC. Although, as the experience of the SWES and the introduction of the CNRF has shown, there is always more we can learn and do. Beyond that, the three key elements I have outlined above can be applied in different institutional settings to achieve similar positive outcomes.

At the heart of what I am advocating for is a strategy policy framework that considers the interaction between monetary and financial stability policy for the effectiveness of central banks to achieve their goals, complemented by clarity in communications about the motivations for those actions in an increasingly risky and uncertain world. Understanding the mutual benefit for monetary policy and financial stability policymakers to share their analyses of the economic environment and potential shocks is at the core of a robust central bank policy strategy framework.

Views expressed here are my own, and do not reflect those of my FPC or other Bank of England colleagues.

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[34] See Bank of England Quarterly Bulletin (September 2024), **Financial stability at the Bank of England.**