People at the helm of central banks are currently enjoying huge power, recognition and public attention. The impact of the measures they take or simply announce (even if it’s merely a bluff), is still enormous. This power notwithstanding, their performance is hardly subject to supervision and, following the traditional privilege of the political class, they seem to be exempt from any liability in cases of negligence or error, even if their mistakes ruin a whole nation. Without a doubt, this is their golden era.

Everything started on Sunday August 15th, 1971. U.S President Nixon told his fellow citizens with a stern countenance: “The speculators have been waging an all-out war on the American dollar (…)”. To defend it, “I have directed Secretary Connally to suspend temporarily the convertibility of the dollar into gold”. As you can see, back then politicians had already developed some bad habits that sound pretty familiar forty years later: making important announcements on weekends; putting to work their favorite smoke screens, that is, accusing the usual suspects (the evil speculators) of all economic malaises that could endanger their reelection; and using the humbug known as a “temporary measure” to smooth the psychological impact of potentially unpopular decisions. Well, to make the story short, that day Pandora’s box was opened once again.

Central banks are the summit of unaccountable power and interventionism, in other words, the politicians’ Garden of Eden. And generally (we can always find some exceptions) central bankers are, or are soon to become, politicians or else simple tools in the hands of politicians. Surprisingly, the mythical central banker is perceived as independent and highly qualified. But the most astounding trait of the myth is the assumption that they have a crystal ball and are capable of accurately forecasting the future, thereby avoiding recessions, making the stock market just go up and, all in all, making all of us much happier. Well, this image is just that: image. I want to focus on their forecasting abilities. For this purpose let’s talk a bit about a well-known character.

Alan Greenspan, President of the Federal Reserve since 1987 until 2006, has probably been the most emblematic of all central bankers, the paradigm. He was worshipped throughout the world, nicknamed “Maestro” and knighted by the Queen of England. Many people read with enormous reverence his unintelligible speeches looking for encrypted prophetic messages. However, common sense first and the passage of time later have shown that such hieroglyphics were just smoke, a marketing tool at the service of the myth. The reality is Sir Alan has a very mediocre forecasting track record and his policies are considered the key cause of the credit bubble that was, or is, on the verge of destroying our financial system.

Arguably the best expert on Greenspan is Fred Sheehan, author of the very
interesting book Panderer to Power and co-author of Greenspan's Bubbles, and whom I am glad to have known for many years. It doesn't seem probable that Sir Alan will invite Fred to have a cup of tea anytime soon, because the detailed study the latter performs of the minutes of the Federal Open Market Committee meetings and the Fed's head interventions in both U.S Congress and Senate do not leave Greenspan's myth unscathed. No surprise there: myths are built on ignorance or, more often, on the oblivion of facts. Let's take a look at his beginnings. In 1987, Greenspan's hearing in front of the Senate Banking Committee as candidate to head the Fed took place. Its Chairman at that time was Senator William Proxmire, who had diligently prepared his case and managed to get his hands on a compilation of the candidate's economic predictions during the preceding ten to eleven years, both in the private and public sectors. He labeled this track record as "dismal". Greenspan tried to make a defense with his typically confusing gibberish, but the firm insistence of the senator and the hard evidence of the data ended up making him acknowledge that "if they're written down, those are the numbers". He shamelessly added that if his forecasts were worse than his peers, "I feel happy for them and sorry for myself". The passage of time, unfortunately, did not improve Sir Alan's predictive abilities. For instance, in January 2000 he welcomed and justified the stock market heights, just two months before the S&P 500 index plunged 45% and Nasdaq suffered a 90% loss; in 2005 he praised subprime mortgages as a consequence of "innovation and structural change". All in all, it seems that not only did he create a bubble: he was a bubble himself. Now, if Greenspan is the "Maestro", the disciples are even worse. Fred has helped me with some jewels from Ben Bernanke, his successor. In February 2006, BB (do not confuse with Brigitte Bardot) predicted that house prices would keep growing, albeit at a slower pace, and strongly discarded a nationwide price decline (since then, prices have gone down by 35%). In June of that same year he asserted that banks were adequately capitalized (since then, 458 have gone bankrupt) and in May 2007 he didn't expect the subprime crisis to spill over to the economy or the financial sector (no need for comments). The largest credit bubble in History went unnoticed by both Greenspan and BB. My goodness, we can all sleep soundly with such sentries!

This side of the Atlantic, crystal balls do not work any better. The euro, banking and sovereign debt crises came out of the blue, like natural disasters, if we are to believe the European Central Bank's comments and actions before they occurred. At the other end of the Channel, the Bank of England showed its eagle eye when it sold half its gold reserves between 1999 and 2002 at an average of $276 per ounce, precisely at the bottom level of the last thirty years. Had any private sector manager accomplished the same feat, he would have been fired, his reputation tarnished. But in the magic world of politicians things work differently: the then Chancellor of the Exchequer, who pushed hard for the deal, was promoted to Prime Minister five years later! This is what I call the privileges of the ruling class.

No central banker has become famous for his forecasting abilities. The time has come to demystify this figure. Both the selection process and the reward system make it a nearly unattainable goal, and the effects of power soon extinguish any remaining hope.

Thus, if these limited and fallible politicians called central bankers, subject to
the usual power-related pathologies, have little capability to predict the future, can we feel reassured when desperate over-indebted governments turn them into the last line of defense? Is there some way we can make monetary policy independent from the weaknesses of policymakers? I’ll try to address these and other issues in the second part of this article.

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