Transparency and Communications

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There are two key factors behind the move to increased transparency on the part of central banks. The first is the relationship between transparency and the effectiveness of monetary policy. The second is the link between transparency and accountability.—C. Freedman and D. Laxton (2009).

Proactive and well-planned communications can improve the effectiveness of monetary policy. Increased recognition of this principle since the inception of inflation targeting has led central banks to devote considerable resources and effort to their communications strategies. One of the key pieces of information published by central banks that implement inflation-forecast targeting is the macroeconomic forecast on which policy decisions are based. Central bank websites provide rapid access to this forecast, to the latest relevant information and policy statements, and to staff research. The checklist in Box 8.1 provides a useful guide to the monetary policy items that central banks release and gives a short summary of the types of publication involved.

COMMUNICATIONS IN SUPPORT OF INFLATION TARGETING

When a central bank first implements inflation targeting, an important message to convey is that uncontrolled inflation is not conducive to a well-functioning economy. Low and stable inflation is a means to the end of a healthy, growing economy that provides jobs and higher living standards in an environment of relative stability. A parallel message concerns the limits of monetary policy. Sound monetary policy is necessary for achieving economic goals but insufficient by itself. Fiscal policy, structural policies, and the framework of regulations are also crucial. Moreover, economic activity is prone to fluctuations; periods of recovery and growth are followed by shorter periods of recession. And while monetary policy aimed at controlling inflation may moderate the business cycle, it cannot eliminate it.

1This chapter draws freely from Freedman and Laxton (2009).
The evolution of flexible inflation targeting has subtly altered central bank messaging. The primary goal remains the same: instilling firm expectations that policy will over time maintain price stability as defined by the inflation target. But instead of insisting on the need to keep inflation low, inflation-forecast targeters have shifted to stressing the symmetry of their reaction to deviations above and below the official target and their dual objective of maintaining high output (Clinton and others 2015). In the wake of the global financial crisis, when the main risk to inflation control has been on the downside and long-term inflation expectations have slipped below target levels, the message that monetary policy will act with due speed to raise inflation has been important for maintaining the stability of the nominal anchor. And inflation-forecast-targeting central banks, in explicit recognition of the trade-off between their dual goals, devote much space in their public materials to assessments of current and projected output gaps.

Inflation targeters try to communicate how the regime will be implemented. As noted in Dooley, Dornbusch, and Park (2002,12), “Creditibility comes from the demonstration that the government has a consistent policy framework and can explain and learn from past errors in the context of that framework.” This means that technical and nontechnical discussions of the goals need to be communicated, along with the central bank’s understanding of the transmission mechanism (and its uncertainties), and an explanation of its chosen target. Dooley, Dornbusch, and Park (2002) emphasize that the approach seeks to appropriately balance stabilizing strong output and keeping inflation on target. This implies a medium-term horizon, with inflation returning gradually to target, since a short horizon would imply sharp policy interest rate responses and volatile output. Thus, while people should expect that in any given month inflation will be off target, they should be persuaded that the central bank’s policy actions will return inflation to target over the medium term. The nominal anchor is the expectation, in all eventualities, that the long-term rate of inflation will be on target. While a consistent pattern of policy responses provides the ultimate basis for a credible regime, clear communications from the central bank on the intent of current policy actions accelerate the credibility-building process.

Under an inflation-forecast-targeting regime, the release of the central bank’s forecast for output and inflation is essential news for the business and financial media. The forecast changes over time because of new information and changes in the interpretation of economic developments. In turn, the central bank’s evolving views on the economic outlook are a central element in the analyses and discussions of academics, financial market participants, and commentators in the business media (including the experts that journalists rely on for comments), who are the main conduit of information to the public. The central bank’s message must be tailored to multiple audiences. These include the public at large, financial markets, the media, parliamentary bodies, and the government.

The central bank’s statement of record is a monetary policy report (sometimes called an inflation report), usually published quarterly, shortly after a policy decision meeting. The monetary policy report sets out recent global and domestic output and inflation developments, an updated outlook, and the implications
for the setting of the policy interest rate. The report describes the central bank’s view of the major forces driving the economy and highlights the risks to the outlook and to the projected interest rate path. It also presents confidence bands around the baseline forecast paths and alternative forecast scenarios based on different assumptions about the driving forces. Transparency requires that the information released in the monetary policy report, including the forecast, corresponds to the information that a monetary policy committee used to make its decision. To amplify the impact of the report, members of senior management meet with interested groups, appear before parliamentary bodies, and deliver speeches and lectures.

The normal convention after a monetary policy committee decision is for the central bank to announce immediately the policy interest rate that will be in place until the next meeting. Soon afterward, press releases provide a brief rationale. Policies toward release of minutes released by a monetary policy committee vary with respect to the details released and time elapsed between the meeting and the time of the release of the minutes. But all inflation-targeting central banks provide a timely description of the range of views among members. This conveys the central tendency of opinion and, just as important, the range of dispersion provides an indicator of the size of the uncertainties confronting monetary policy. This gives the markets an understanding of which developments will be central to the bank’s thinking on interest rate decisions over a certain time frame, and how it might react to new information in the areas where it expresses most uncertainty.

Modern communication technology provides numerous platforms for reaching the public—websites, blogs, Twitter, Facebook, and so on. Ideally, use of these should be integrated and complement each other. Otherwise, there is a risk of over-communicating, and transmitting mixed messages through the various channels.

**Publishing the Central Bank Forecast**

The model-based staff forecast presented to the monetary policy committee meetings of inflation-forecast-targeting central banks provides a coherent macroeconomic narrative, linking the current and forecast settings of the interest rate instrument to the inflation and output objectives. As discussed in Chapter 3, all inflation-forecast-targeting central banks publish explicit forecasts for medium-term inflation and output growth, as well as information on the projected policy interest rate in their baseline forecast. A key reason for transparency about the forecast is that it helps guide expectations, among the public and in financial markets, in support of the objectives of policy.

In all cases, the central bank’s communications indicate not just a possible path for the future policy rate, but also a sense of how it might change in response to a variety of developments. Most central banks publish just a verbal, qualitative, description of the forecast rate path. For example, the December 2017 Monetary Policy Report for Chile indicates that the policy rate “remaining fairly stable to start approaching its neutral level only once the economy begins to close the gap.”
Their view is that the monetary policy committee must be free to adjust policy rates to all possible contingencies, and that they do not want to confuse the public by appearing to have a commitment toward the interest rate (Freedman and Laxton 2009). However, a group of central banks in the avant-garde on inflation targeting (including the Reserve Bank of New Zealand, the Czech National Bank, Sverige Riksbank, and Norges Bank) release the full forecast, including the projected numerical path of the policy rate. The publication of confidence bands and alternative scenarios embodying different sets of assumptions underlines the uncertainties that attend the forecast and the conditionality of the interest rate path.

Publishing the forecast rate path—which in this book is called conventional forward guidance—strengthens the transmission of policy actions. The evidence shows that financial market participants quickly adapt to the conditionality of the rate forecast and do not take it as a commitment from the central bank. For example, Ferrero and Secchi (2007), in a cross-country study, find that the announcement of policy intentions improves the ability of market operators to

**Box 8.1. Communicating about Monetary Policy**

**What to Communicate?**

A hierarchy of required content might go as follows:

- Mandate
- Numerical inflation objective
- General strategy that guides central bank decisions
- Reasons for actual decisions in the period under review
- Assessment of current economic conditions and output gap
- Forward-looking assessment of inflation pressures
- Macroeconomic forecast highlighting output and inflation (that is, policy objectives)
- Main risks around the forecast and their distribution (for example, weighted to one side, or balanced)
- Description of relevant actual policy trade-offs in the context of the forecast
- Endogenous future path of the policy interest rate (the instrument)

The first three points are usually covered in a “boilerplate” statement, repeated at the start of each monetary policy report.

Practices vary across institutions with respect to communicating quantitative information such as explicit numerical forecasts versus qualitative communications such as descriptions of the forecast. Most inflation-targeting central banks publish forecasts of inflation and GDP growth and estimates of the output gap in their monetary policy reports. Only a small avant-garde group publishes interest rate forecasts.

**Common Media**

- Quarterly monetary policy report, sometimes known as the inflation report, containing all the above content
- Press conferences to explain and answer questions about objectives, decisions, and the forecast assumptions
- Minutes of monetary policy committee meetings describing the range of views expressed
predict monetary policy decisions. In New Zealand, the short-term yield curve responds to surprises in the release of the path, indicating that market participants take the forecast seriously.

The experience of Norges Bank before and after November 2005, when it began to publish its forecast interest rate path, is similar. Figure 8.1 shows the change in the 12-month interest rate that followed the bank’s announcement of a revision in the policy rate. The size of the change was lower after Norges Bank started to publish the explicit forecast. Financial markets evidently got a better idea of its monetary policy intentions, and the element of surprise in the actual policy rate change was reduced.

Moreover, conventional forward guidance may avoid the awkwardness associated with ad hoc forward guidance, as practiced by the Federal Reserve and many other central banks after the global financial crisis, since it supplies the market with a regular flow of quantitative information on the central bank’s intentions for policy instruments (Alichi and others 2015). In contrast, an ad hoc flow of verbal communication on forward guidance may provoke varying interpretations, and financial markets might misunderstand its implications. For example, during the 2013 “taper tantrum,” bond yields rose far more sharply than warranted by the Federal Open Market Committee statement about a gradual reduction in quantitative easing (Bernanke 2013). As policy moves from a prolonged period of ease with rock-bottom interest rates, the publication of the expected gradually tightening path for the interest rate and for quantitative easing, in precise numerical terms that are free of ambiguity, would allay the risk of an unwarranted snap-back in bond yields much more effectively than verbal descriptions of likely changes in the instruments.

Sources: Thomson Reuters; and Norges Bank.
Institutional Modalities for the Forecast

Ownership of a published central bank forecast package may be an issue: are the forecasts owned by staff forecasters or policymakers? It seems better in many advanced economies with established histories of credible inflation targeting to regard the central bank forecast as belonging to staff rather than senior management, but this is a pragmatic judgment and would not apply to all circumstances.

The technical complexities—deriving model-based baseline forecasts, confidence intervals, and alternative scenarios—inevitably involve input from highly specialized staff. Senior managers of the institution would be expected to make sure that these resources were adequate to the job, and to have confidence in the technical quality of the forecast and associated analysis. Their role should also be to make sure that the forecasting team takes account of policymakers’ views on the major issues. With a properly functioning forecasting and policy analysis system, the range of opinions within the monetary policy committee concerning the outlook would generally be reflected in alternative scenarios prepared by the staff, if not in the baseline, and in their analysis of uncertainties.

In other words, in a broad sense, the monetary policy committee bears responsibility in the public view of the institution. Its members defend the system that produces the forecast and the overall quality of the forecasts as inputs to decision making. However, regarding the contents of a given forecast, monetary policy committee members should focus on broad, strategic questions. They need not be closely connected to the production process, and probably should not be, considering the high-profile tasks that demand their time and attention. In public, they need not necessarily defend any aspect of a single forecast package.

As input to decision-making, the forecast—including the alternative scenarios and risk analyses—is one among the many inputs policymakers consider, though normally it is the most important one. However, it is vital that members of the monetary policy committee do have solid economic arguments for their views in circumstances when they differ from those of central bank staff. For example, at times it may be uncertain whether recent inflation pressures are persistent or transitory. In the former case, central bank action may well be required to counter the pressures, while in the latter, the problem unwinds itself without any central bank action. Another example would be where the baseline projection is for a slowdown, and hence a reduction in the rate of inflation, but the projected slowdown is not yet reflected in the data. Whether the central bank should ease immediately, or take a wait-and-see stance, can be the subject of legitimate disagreement.

Communications may be simpler when the forecast is presented as a staff input. The alternative approach, in which the monetary policy committee takes ownership of the projection, may be more difficult at a central bank where decisions are made by vote, not by consensus (or by the central bank governor alone). Voting members may have divergent views that cannot be represented in a single forecast. Because of more limited data, more rapid structural changes, and greater external exposures and uncertainties, monetary policy
committee members in emerging market economies are more likely than those in advanced economies to have different views on how the economy functions, and on the depth and duration of disturbances. Where there is no consensus, a central bank with seven voting members might have to publish as many as seven projections in the monetary policy report. And how would all this be accommodated in the write-up that explains policy? Such an approach would likely be inefficient internally and confusing to the public. Instead, a published staff forecast would be a point of reference with which individual members could compare their own views. Clear and transparent explanations of such differences in the monetary policy report would help financial-market participants to understand the central bank’s action (or absence of action). It might even increase the credibility of the central bank, since the debate would shed light on how it would react when future data reveal which of the opposing views was more valid. (The extent to which individual views in monetary policy committee policy debates should be published is a separate issue that is not examined here.)

As one example, the following statement is taken from the Czech National Bank’s Inflation Report.

The forecast is the key, but not the only, input to our monetary policy decision-making. Unless the economic situation requires an extraordinary monetary policy meeting, the Bank Board meets eight times a year to discuss monetary policy issues. At four of the meetings (in February, May, August and November) we discuss a new forecast, while at the other four (in March, June, September and December) we discuss the risks and uncertainties of the most recent forecast in the light of newly available information on domestic and foreign economic developments. Due to the arrival of new information since the forecast was drawn up and to the possibility of the Bank Board members assessing its risks differently, the decision we adopt may not fully correspond to the message of the forecast prepared by our experts. (CNB Inflation Report, IV/2017)

There are, however, caveats to this approach. In some countries, the central bank governor, rather than a committee, is accountable for the conduct of monetary policy. New Zealand is an example. Since the governor may well set the main themes of the forecast, she or he must therefore defend it in justifying the policy actions. In many emerging market economies, or ones that do not have a long history of inflation targeting, monetary policy committee members are expected to engage thoroughly in setting the assumptions. As the central bank builds its credibility, the governor and other members may provide extensive information about the forecast, explaining the reasons behind deviations as new data are released, or any changes in model assumptions. Since they share responsibility for the forecast, they must be prepared to defend it in public. In some countries, the overriding communications priority may be to promote a commitment to the inflation target without confusing the issue. Nuances that may be appropriate in countries where the public is accustomed to receiving a large daily volume of information on economic and financial developments may not be appropriate in others.
IMPROVED ACCOUNTABILITY

In addition to improving monetary policy effectiveness, the trend to greater transparency helps improve accountability. This is a necessary counterpart to operational independence of a public agency in a democracy. Increasingly, central banks around the world are given responsibility for monetary policy in the context of objectives defined in legislation or treaty, or in agreements between the government and central bank. A formal process holds central banks, as unelected bodies, accountable for their stewardship of policy, and they answer by a formal process to government or parliament and, in a more general way, to the public at large. For the process to be effective, the oversight body must have sufficient information to evaluate the conduct of monetary policy. As such, increased accountability and increased transparency take the same path.

Accountability requires the central bank to regularly provide information on (1) where inflation is in respect to the target, and why the outcome differs from what had been expected; (2) what the outlook for inflation is in the changed circumstances; and (3) what can be done under these circumstances to bring inflation back to target. This type of explanation is typically provided in the monetary policy report. Another element of accountability is the required appearances of the governor and members of the monetary policy committee before parliamentary committees to explain the policy framework and the central bank’s views on current economic developments, and to justify any recent interest rate actions. Speeches by the governor and other members of the monetary policy committee at a wide range of events provide other avenues of accountability to a broader public audience.

It is not required that inflation-targeting errors be small. Accountability does not mean that the central bank must score success after success in having outcomes within a prespecified band. More important is that the shocks causing the inflation rate to fall outside the band can be explained, along with why they could not have been foreseen and prevented, and what policy interest rate path is likely to bring inflation back to the target over the medium term. What this may imply for output and employment should also feature in announcements. Indeed, deviations from target provide the central bank with a public communications opportunity to explain the nature of its systematic policy response for returning inflation to target.

Longer-term assessments of policy conduct are appropriate at times when the existing target is up for review. For example, the statement of objectives in the agreement between the Bank of Canada and the government of Canada has a five-year term. A thorough review of the preceding term precedes each renewal and features the new developments and difficulties that policy has had to confront, alongside examination of possible modifications to the inflation-control-target renewal agreement (Bank of Canada 2016). Academics, journalists, and other outside policy analysts air their judgments of the monetary policy record and their opinions on whether the framework should remain as is or be changed.

COMMUNICATING UNCERTAINTY

An issue with which central banks struggle is how best to characterize and communicate the risks around their baseline forecasts. Monetary policy reports often
present confidence bands, or fan charts, around the forecast paths for inflation and the output gap, and so on. These are useful in describing the normal range of risks surrounding the baseline forecast. Likewise, discussions in the monetary policy report provide a verbal description of the main risks perceived by the monetary policy committee, and whether they are likely biased in one direction or the other. Alternative scenarios illustrate the uncertainties implied by shocks that committee members judge as relevant and beyond the normal range of random variability. Importantly, a central bank would indicate how the policy rate might respond should any of the suggested shocks eventuate. That is a concrete and effective method of communicating to the financial markets the nature of the perceived risks and of the systematic policy reaction function.

Published minutes of monetary policy committee meetings are another channel for communicating uncertainties. They may provide a different, livelier perspective of the range of members’ views than charts of confidence bands and alternative scenarios. However, if minutes are published, the discussion of the differences in views of members must be framed to promote increased understanding of the issues confronting the committee and to avoid confusion. Blinder (2009) warns that communicating a diversity of views may give an accurate picture of uncertainty, but at the expense of clarity of message. In a system with decision by majority vote, not all members of the monetary policy committee will be able to use only the consensus outlook in their presentations. Commentators and markets would expect members to air their different views when there is a split vote.

**COMPLICATIONS ASSOCIATED WITH A FINANCIAL STABILITY MANDATE**

Modifying the inflation-targeting mandate to recognize a financial stability objective for monetary policy raises awkward communications issues for monetary policymakers. Such a mandate would involve diverting from the policy interest rate path that would, according to the central bank’s forecast, best achieve the inflation target, with the purpose of that diversion being to moderate financial sector disturbances. The communications strategy of the financial regulator regarding macroprudential instruments is less problematic. In the discussion that follows, for simplicity’s sake, the monetary policy function and the regulatory function are regarded as separate—even though they may both be under the central bank, as they are in many jurisdictions.

The primary goal of monetary policy communications is to promote positive outcomes—namely, to anchor expectations on the inflation target. In contrast, macroprudential policy communications aim at avoiding negative outcomes—and their focus tends to change over time. During normal times, effective communication discourages excessive optimism about asset prices and credit risks. Thus, macroprudential communications paint downside-risk scenarios, highlighting perceived vulnerabilities in the financial system and the risk of bad events that might cause system-wide failures, drawing attention to tail events. During crises, the messaging from the central bank switches to assurances that the
banking system has an ample supply of liquidity, encouraging calm, and statements of confidence that normalcy will be restored in a timely manner.

The communication challenge may be immense when monetary policy “leans” to subdue sustained credit growth or asset price movements, the two main indicators for macro-financial stability (Borio 2014). Monetary policy and financial stability actions then merge. If asset prices and credit growth are not deemed to be excessive, the policy rate setting may aim exclusively at achieving a desirable path to the inflation target, for example, that described by the central bank’s macroeconomic forecasting model. If asset prices and credit growth are judged to be out of line, the policy rate path would change, as would the forecasts for inflation and output. In addition to reporting on the expected future paths of output, inflation, and the policy interest rate, a central bank with an integrated inflation target–financial stability mandate would report on the projected paths of credit conditions and asset prices, and on the risk of a serious financial shock. Since the business cycle and the credit cycle are not synchronous, they may point in different directions with regard to an appropriate stance for monetary policy.

REFERENCES