

Amando M Tetangco, Jr: The role of communication in ensuring effective central banking

Keynote address by Mr Amando M Tetangco, Jr, Governor of the Central Bank of the Philippines (Bangko Sentral ng Pilipinas), at the Second IMF Regional Seminar on Central Bank Communications, Makati, 8 July 2007.

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Mr Ariyoshi, Mr. Reza Baqir, members of the BSP Monetary Board, distinguished speakers, fellow central bankers around the region, other officers of the IMF, good morning. On behalf of the Bangko Sentral ng Pilipinas, I bid our guests a warm welcome to our country!

You have traveled far for this Second IMF Regional Seminar on Central Bank Communications. This conveys, in very strong terms, the significance you attach to the role of communication in ensuring effective central banking.

No doubt, the sea changes in global finance and markets as well as in the domestic macro-economy have posed significant effects in the conduct of monetary policy. In particular, we have seen the rapid evolution of monetary policy towards increased transparency. I share the general observation that secrecy or deliberate obfuscation are no longer the buzzwords in central banking circles.¹

In sharp contrast to the past practice of reticence among monetary authorities, greater emphasis on effective communication is now a best-practice policy among central banks around the world. In fact, in the last two decades or so, we were witness to an expansion in disclosure mechanisms employed by central banks. Moreover, there has been a dramatic change in the nature and quality of information that monetary authorities are now willing to disclose.

This morning, I will share some of my thoughts on central bank communication in general and provide you with an overview of the communication strategy that we employ at the Bangko Sentral, with focus on our framework for communication with other government agencies.

I. The importance of central bank communication

The move toward greater transparency is a key element of good corporate governance. Central banks have become increasingly independent so there is scope for greater accountability. After all, a central bank is a public office whose policy decisions have an important bearing on the direction of the economy.

Thus, the central bank should be able to clearly define its goals and provide a compelling explanation behind its policy actions. In turn, transparency allows for an honest assessment of central bank performance, given the goals it has pledged to achieve.

The emphasis on better transparency practices also recognizes the idea that transparency makes monetary policy generally more effective, in part by ensuring that market expectations are formed efficiently.

¹ See for example: Blinder, Alan, Charles Goodhart, Philipp Hildebrand, David Lipton and Charles Wyplosz (2001) How Do Central Banks Talk? Geneva Reports on the World Economy 3, Geneva: International Center for Monetary and Banking Studies

As central bankers, we are aware that the potency of monetary policy actions can be strengthened if markets understand the overall intention behind the central bank's policy decision and the results it expects to achieve.

Indeed, the emergence of "open mouth" operations as a policy tool outside of the traditional channels of monetary policy has been recognized by central bankers.

As pointed out by Ehrmann and Fratzscher (2005): "Central banks have direct control over a single interest rate, usually the overnight rate, while their success in achieving their mandate requires that they are able to influence asset prices and interest rates at all maturities" .

In the case of the Bangko Sentral, we typically adjust our overnight policy rate, when necessary, by increments of as low as 25 basis points. If we really think about it, we do not expect that such a marginal adjustment in a very short-term instrument will do the job for us. Rather, we rely on the markets to interpret our signals properly and allow for appropriate adjustments in the prices of financial assets that really matter, including the longer-term tenors.

In general, central banks now avoid surprising the market since this could generate unwarranted volatility. This is where communication comes in: it increases the predictability of policy decisions and helps the market anticipate how the central bank might react to a particular situation, event or development. Indeed, good transparency practices promote greater market efficiency.

For an inflation targeting central bank such as the Bangko Sentral, communication is crucial in anchoring inflation expectations. To help guide public expectations, it is incumbent upon an inflation targeting central bank to disclose its outlook for future inflation. Managing the expectations channel is, therefore, critical.

Apart from influencing the market with its policy actions, communication also allows the central bank to obtain useful feedback from its stakeholders, which in turn is an important input to policy formulation.

Given these arguments in favor of communication, the next critical issue is the extent of transparency. How transparent should central banks be?

My view is that central banks should take a pragmatic approach to communication. While transparency is a good policy, excessive transparency could hamper the effectiveness of monetary policy and potentially harm market stability.

Specifically, extensive disclosure requirements about internal policy discussions on money and exchange market operations might disrupt markets, constrain frank discussion by policymakers, or prevent adoption of contingency plans.

In other words, good transparency practices should allow for flexibility to take into account country-specific circumstances. After all, there is no one-size-fits-all formula for central bank communication.

II. Communication between the central bank and other government agencies

Let me now turn to the importance of communication between the central bank and other government agencies.

While most central banks enjoy independence from other branches of government, continuing coordination with other government agencies for macroeconomic policy formulation remains an imperative. Inter-agency arrangements should be in place to ensure consistent and coherent economic policies. After all, monetary and fiscal policies, along with other government policies, are interlocking elements of the country's overall macroeconomic strategy.

The consensus among economists and policymakers is that well-coordinated policies are integral to durable, broad-based and strong economic growth. As such, fiscal and monetary authorities, as well as other economic managers in government, should share information and be aware of their agencies' respective policy intentions and decisions. A silo approach to government policy formulation, where one agency formulates policy on its own without consultation, does not and will not work.

In fact, the absence of coordination among policymakers could undermine the credibility of the country's macroeconomic policy. As Worrell (2000) argued in his paper: "the invariable consequence of any appearance of conflict among the authorities is an increase in uncertainty in financial markets, a loss of credibility of macroeconomic policies and an increased probability of price and output instability". Thus, good communication with other economic managers is of prime importance in macroeconomic management.

The same principle applies in the field of financial supervision. Even in central banks with financial supervision functions such as the Bangko Sentral, jurisdiction over the financial sector is often shared with other government supervisory agencies. In the Philippines, for instance, supervision over non-bank financial institutions without quasi-banking functions is shared by the Bangko Sentral, the Securities and Exchange Commission and the Insurance Commission. This underscores the need to maintain close coordination among these agencies to ensure consistency of policies, as well as access to timely and accurate information.

An important caveat in communication between the central bank and other government agencies is the responsibility to respect the confidentiality of sensitive information being shared.

III. The BSP's communication strategy

The Bangko Sentral, like many other central banks, continues to enhance its communication strategy to reach all its stakeholders. Our adoption of inflation targeting in 2002 served as an additional stimulus for us to work on improving our transparency practices.

In dealing with the press and the market, the Bangko Sentral employs a wide range of disclosure mechanisms. One of these mechanisms is the BSP website which carries our press statements, statistical releases and our advocacies.

In the area of monetary policy, a press statement is issued immediately after each monetary policy meeting. Typically, each policy statement contains the reasons behind the Monetary Board decision, along with a brief discussion on the outlook for future inflation.

The highlights of our policy meetings are also made public after a predetermined lag of four weeks. The highlights were initially published with a lag of six weeks but we shortened it to four weeks, beginning July last year, to further improve transparency in monetary policy-making.

We also publish a quarterly Inflation Report to document the rigorous economic analysis behind the conduct of monetary policy and inform the public of the overall thinking behind our decisions. The release of the Inflation Report for each quarter is accompanied by a briefing for the media and market analysts.

In cases of a breach of the inflation target, the BSP issues an open letter to the President to account for the reasons behind it and to outline the actions that will be undertaken to bring inflation back to the target range.

Further, we conduct public information campaigns across the country to foster better understanding and support for the central bank's policies and programs. The Bangko Sentral also conducts regular dialogues with the press and periodic engagements with its various constituencies.

In the Philippines, the generation of macroeconomic assumptions and formulation of government's medium-term budget strategy is done by the Development Budget Coordinating Committee, which is composed of the Department of Budget and Management, and the Department of Finance, the National Economic and Development Authority and the Office of the Executive Secretary. The BSP used to be a member of this committee but, in recognition of its administrative and fiscal autonomy, was re-assigned as a resource institution.

Under the inflation targeting framework, the inflation targets are set by the Committee in coordination with the BSP. This effectively commits the Government as a whole to the inflation target. Equally important, this ensures that our monetary policy actions remain consistent with the Government's economic policy agenda, even as we maintain our independence.

In the field of financial supervision, the Bangko Sentral has cooperative arrangements with other financial regulators. Among others, the Bangko Sentral chairs the Financial Sector Forum which includes the members of the Securities and Exchange Commission, the Insurance Commission and the Philippine Deposit Insurance Corporation. It focuses on three broad areas: harmonization of supervisory and regulatory policies in the Philippine financial system; information exchange; and consumer education or financial literacy.

In addition, the Bangko Sentral is in various stages of negotiations with foreign supervisory authorities for the adoption of minimum ground rules on information sharing involving cross-border financial institutions under their supervision. Through this initiative, we hope to strengthen cooperative arrangements with our foreign counterparts.

Another important dimension of our interface with the government is our interaction with the Executive and Legislative branches of Government. As mandated in our charter, we submit regular reports to the President and both houses of Congress. These include a report on economic and financial conditions, a report on the central bank's financial condition, and a review on the state of the Philippine financial system. The BSP is also required by law to report to the President and Congress any unusual movements in monetary aggregates, credit and price levels, as well as the remedial measures undertaken by the Bangko Sentral to correct them.

In addition, the Bangko Sentral engages in a variety of informal interactions with the other branches of government through appearances in committee hearings in both houses of Congress and its participation in various government inter-agency committees and working groups.

In other words, we invest time and resources to communicate our policies and programs with other branches of government.

IV. Concluding remarks

This IMF seminar, therefore, comes at an opportune time when central bank communication has emerged as a potent policy tool, rather than a mere channel to transmit information. As an institution that recognizes the significance of communication in making our operations more effective, we at the Bangko Sentral are pleased to co-host this Second IMF Regional Seminar on Central Bank Communication.

This seminar should build on the IMF's initiative, which started in Mumbai, to provide a forum to discuss emerging issues in central bank communications and gain insights from one another's experiences.

We thank the IMF and their representatives who are here with us this morning...for setting up this forum for central bank communication in this region.

Finally, I wish this seminar on central bank communication will be fruitful and highly successful, not only in terms of generating fresh perspectives but also in fostering regular exchange and cooperation among the participants.

Have a wonderful stay in our country. Thank you and Mabuhay!