Gill Marcus: Transparency, communication and democracy

Address by Ms Gill Marcus, Governor of the South African Reserve Bank, to the South African National Editors' Forum (SANEF) at the Nat Nakasa Awards, Durban, 28 July 2012.

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Good evening and thank you for the opportunity to address you this evening. You as members of the media are at the forefront of information dissemination. You pursue stories, are seminal in bringing issues to the attention of the public, and help inform and shape the discourse in society. And therefore you have a heavy responsibility to ensure that your reports are accurate and the information conveyed in such a manner that the reader and ordinary citizen has the ability to interpret and judge for themselves. But it is not just a matter of getting the correct facts, it is also how you analyse and convey such facts that is important. Differences in nuance or how a headline is phrased can change or shape the readers' interpretation of seemingly objective facts. What a democratic country needs is an informed public, a public that is knowledgeable and able to express views precisely because it is knows what is happening, both globally and domestically.

In 1976 Erich Fromm, recognised as one of the world's most influential thinkers on social issues, when outlining what could be done to create a better society, wrote in *To Have or To Be*: "A system of effective dissemination of effective information must also be established. Information is a crucial element in the formation of an effective democracy … the so-called great newspapers inform better, but they also misinform better; by not publishing all the news impartially; by slanting headlines in addition to writing headlines that often do not conform with their accompanying text; by being partisan in their editorials, written under the cover of seemingly reasonable and moralising language. In fact, the newspapers, the magazines, television and radio produce a commodity: ***news***, from the raw material of events, and barely gives the citizens an opportunity to penetrate through the surface and recognise the deeper causes of events … The information problem must be solved in a different way if informed opinion and decision are to be possible."

Transparency and communication have become integral to modern central banking, and although part of our communication is directly with the markets or the public, it is generally reported by the media as well. In this way how you report may impact on the interpretation and understanding by the public of our communications.

More open communication by central banks is a relatively recent phenomenon. In his colourful narrative "Lords of Finance", Liaquat Ahamed describes central banks as "mysterious institutions, the full details of their inner workings so arcane that very few outsiders, even economists, fully understand them". Karl Brunner, writing in the early 1980s, rather unflatteringly referred to the "mystique" of central banking that "thrives on the pervasive impression that Central Banking is an esoteric art … The esoteric nature of the art is moreover revealed by an inherent impossibility to articulate its insights in explicit and intelligible words and sentences". Similarly, when a US senator said that he understood a comment made by Federal Reserve Bank Chairman Alan Greenspan, Greenspan famously replied: "If you understood what I said, I must have misspoke".

However, Greenspan was in fact at the forefront of what Alan Blinder called the "quiet revolution" or the opening up of central banks during the 1990s. As recently as the early 1990s, the Federal Open Market Committee (FOMC) of the US Fed would meet and not in fact announce its monetary policy decision. Market watchers would then have to deduce from the Fed's actions in the money markets what the stance of monetary policy actually was.

The "quiet revolution" is in fact about central banks not being so quiet anymore, and central banks are now anything but arcane. Transparency and its corollary, communication, have become fundamental to central banking operations and strategy. The South African Reserve

Bank has not been left behind in these developments, with a marked evolution towards greater transparency and more open communication, particularly since the introduction of inflation targeting in 2000. There are two broad thrusts to our communication. The first is to create greater awareness about what the Bank does, what it should do, what it cannot do, and what it should not do. The second relates to the predictability and transparency of monetary policy. I will make a few comments on both of these issues.

With respect to communicating what the central bank does, this is particularly important in the current climate of heightened global uncertainty and fragility. Central banks are being viewed as having powers way beyond their capabilities, and as more and more governments hit fiscal constraints, central banks are seen, in my view somewhat unreasonably, as the saviours of last resort or of only resort. Central bank mandates are becoming increasingly blurred as they are expected to, inter alia, simultaneously control inflation, generate growth, solve the unemployment problem, control interest rates, control exchange rates and capital flows, build reserves and ensure financial stability. Some areas, such as macroprudential policies, are still unchartered territory. But it is important that central banks have clear and achievable mandates, and for these to be communicated. Central banks build up credibility by achieving their goals, but can lose credibility and indeed legitimacy if they fail to achieve goals that society believes they ought to achieve but are beyond their capabilities. In South Africa, there have been periods when this lack of understanding of the role and scope of monetary policy resulted in the Bank becoming a lightning rod for all that was wrong in the economy, and unrealistic demands and expectations resulted.

In order to try and contribute to this better understanding of the role of the Bank, we introduced an outreach programme which involves regular interaction with various stakeholder groups including political parties, trade unions, business groupings, different sectors of the economy and civil society. The Governors and senior staff speak at various forums and universities. Numerous meetings and interactions with investors, both domestic and foreign, take place on a continuous basis. We try to be as accessible as far as is reasonably possible, but at the same time ensuring an appropriate black-out period before MPC meetings. As part of our outreach programme we convene an economists' round table on alternate months to the MPC, where economists and analysts from various sectors are invited to discuss topical issues with the Governors and other senior staff of the Bank. The aim of this outreach is not to preach or to take instructions. It is an interactive process of sharing information and ideas. We do not always agree. But we have found that the process has increased knowledge, mutual understanding and respect. Furthermore, in conjunction with the release of the Bank's Monetary Policy Review we arrange a series of Monetary Policy Forums in 10 venues around the country, and each MPF is attended by at least one member of the MPC. This gives stakeholders and the general public the opportunity to interact with policy-makers.

The issue of communicating monetary policy and in particular the future monetary policy stance is perhaps more contentious. The modern view is that central banks should not surprise the markets, but should rather guide them. This then implies more predictability which requires transparency and greater emphasis on communication. Improved and more open communication with respect to monetary policy has therefore been one of the main thrusts of central banking reform in the past two decades.

Innovations in transparency and communications at the Bank include the MPC statement issued at a press conference after each MPC meeting; the publication of the Bank's forecasting model; and publication of the Bank's forecasts for inflation and GDP growth.

Furthermore the Monetary Policy Review (MPR), which is published twice a year, gives a more in-depth guide to our thinking about monetary policy. More recently we have been giving the market more guidance as to how we view the risks to our forecasts. A number of independent academic studies have confirmed the increased predictability of monetary policy in South Africa. A study by Janine Aron and John Muellbauer at Oxford University shows that the forward rate agreements (FRAs) have anticipated repo rate changes well since the introduction of inflation targeting. More recently Monique Reid and Stan du Plessis at Stellenbosch University have shown that the MPC has succeeded in signaling its likely future policy decisions with consistency over the inflation targeting period.

Explaining our actions is a central part of our communications. Again, this is a break with the traditional past, as illustrated in the earlier quote by Brunner. In a similar vein, Ahamed describes how Montagu Norman, governor of the Bank of England between 1920 and 1944, when asked by a parliamentary committee what his reasons for a particular policy were, tapped the side of his nose three times and said: "Reasons, Mr Chairman? I don't have reasons. I have instincts". In today's world of central banking and monetary policy making, reasons are critical as they guide markets as to the thinking of the policy makers. Sound policy-making cannot be subject to ad-hockery. To be sure, subjective judgment comes into any decision-making involving forward-looking analysis, but it has to be backed up with sound and consistent theoretical basis or logic.

While it is generally accepted that transparency is the way to go, there is less agreement about the limits to transparency and there will be disagreements over where to draw the line. One area where there has been a radical departure in communication by some central banks has been the guidance given with respect to the future path of interest rates. This has become a contentious issue and at this stage there is no generalised agreement as to "best practice". Some central banks reveal a bias in their thinking about future interest rates or the balance of risks with respect to their forecasts. Broadly speaking, an upside risk to an inflation forecast which is already close to the upper end of the target range could reflect a higher probability that the next interest rate move would be up, although it does not reveal anything about the timing, the extent or the path over the forecast period. An upside risk however could also mean that a possible rate cut could be delayed. We have moved in the direction of revealing our risk perceptions, and recent MPC statements have indicated how the MPC views the balance of risks to inflation and growth forecasts.

A different approach is taken by central banks in New Zealand, Norway and Sweden, where the expected path of official interest rates is revealed. This is an extreme form of transparency, but the jury is still out as to how helpful this actually is. Initially the skepticism around this approach related to the risk that market participants and the general public would interpret this as an unconditional commitment to act in the way specified. To date, this does not appear to have been a problem in these countries, despite the fact that these forecasted future paths change frequently. That they change frequently should not be a surprise: any future path would be conditional on the current circumstances remaining the same, and as we know, things do not remain the same, particularly in the current crisis environment that we find ourselves in.

The eminent monetary economist Charles Goodhart argues that it is not so much the understanding of the conditional nature of the forecasts but more their usefulness, as a lot depends on the relative accuracy of these forecasts. As he argued in a recent Financial Times article: "If official predictions contain additional information beyond that already implied by market forecasts of the term structure of short-term interest rates, then well and good. If not, then all central banks are doing is exposing that they are as clueless about the future as the rest of us". Similarly, Otmar Issing, a former Executive Board member of the ECB, has recently argued that in the context of the financial crisis and the subsequent elevated uncertainty about the impact of the crisis on potential growth, it is difficult to see how signaling the future path of interest rates based on such "shaky ground" can reduce uncertainty and guide expectations.

Research undertaken by Goodhart shows that in the short run i.e. over the next three months, and to a lesser extent over the subsequent quarter, the central bank may have inside information about its own future actions. But beyond that, he argues, the extra informational content of central bank forecasts is zero, and that pressures to push central banks in the direction of publishing their interest rate forecasts are, in his view, “retrograde”. He argues further that the move by the FOMC to publish individual (but not attributed) views of when interest rates should change reveal such wide divergences as to be unhelpful.

The reality is that the further we go into the future, the less confident we can be about our future actions. I do not know what the world will look like in a years’ time. It follows that I cannot be certain what the domestic economy and therefore domestic interest rates will be. I could give you my best guess, or a forecast based on all available information and reasonable assumptions, but this is likely to be wrong. Monetary policy operates in an uncertain environment all the time. We are constrained by the unknown, in the same way that the rest of the market is, and unfortunately central bankers are not bestowed with superior foresight. Yet we take decisions looking into this unknown future, while trying to see through the prevailing noise and uncertainties. And in acting in this way we also influence, however slightly, that future.

At best, as Goodhart suggests, central banks can focus on a range of possible outcomes (not focus on point forecasts), on potentially varying scenarios and on the need for flexibility, not pre-commitment, to respond as the unknowable future unfolds.

We are treading carefully in this respect, as signaling is difficult because of its conditional nature. However there have been times when we have given direction. For example, at the time of the May MPC meeting, the market appeared to be focused on the timing of the next interest rate increase, and we felt it was important to signal that the risks to the interest rate outlook were not only on the upside, and that should the global environment deteriorate significantly, the MPC would be prepared to respond by reducing the policy rate. Hence our statement that the MPC stood ready to move in either direction, as appropriate. In other words we were communicating that should inflation move out of the target range on a sustained basis, the MPC would be prepared to tighten policy, but in the event of a severe global downturn, monetary policy could in fact be eased. Judging by the response of the FRAs at that time to our signal, it seems that we were heard. The FRAs declined and reflected a high probability that the repo rate would be reduced before the end of the year, but expected the rate cut to come later. But it is again important to stress that this was not a commitment to lower interest rates. Rather, it was a signal that should the circumstances arise, we would be prepared to act. The reason for the signal was that we believed that the probability of this scenario unfolding was not negligible. And our concerns about the global economy were expressed strongly in our statement.

At the subsequent meeting, we felt that the inflation and growth dynamics had changed sufficiently to justify further monetary accommodation. Since then, there has been much speculation as to whether the interest rate reduction was the beginning of a new interest rate cycle or whether this was a one-off move. At the beginning of an interest rate cycle, it is easy to forecast and signal the direction and timing of the next move. But the turning points are always more difficult to call. We view the recent move as part of the easing cycle that began in the wake of the crisis. We had previously thought that we were at the bottom of the interest rate cycle, but events unfolded in an unexpected way. Further easing, however, cannot be taken for granted and will be contingent on changing global conditions, further inflation and growth developments.

I should emphasise that it is also important for the markets to pick up the signals from the changing fundamentals in the economy. If the fundamentals or circumstances change all of a sudden, this may lead to a change in policy. But our reaction should only be a surprise to the market if the market has not interpreted correctly how the initial surprise will impact on Bank thinking. Of course, if we act in an inconsistent way, then we would create further uncertainty. That would not be our intention. But there may be times when our signals may have been misinterpreted, and it may then be necessary to correct that misconception. The central bank must have credibility and act in a consistent manner in response to various shocks, as far as is possible. And part of successful communication would be that markets, analysts and yourselves would expect us to respond to significantly changed circumstances, and would not be surprised when we did so.

However, central bank communication is not the only source contributing to market expectations of monetary policy. Hervé Hannoun of the Bank for International Settlements, for example, has argued that large global financial institutions, through their research and analyses to clients and to the media, also influence public and market expectations of monetary policy, to the extent that they could be trying to influence or lead central bank thinking. In some instances it could be argued that their interpretation of what central banks are saying becomes more important than what central banks are actually saying. It is therefore important that central banks retain their independence from the markets. We must hear what the markets are saying, and communicate with the markets, but in the end we need to do what we think is right, irrespective of what the market thinks, and not slavishly follow the market. After all, the "market view" is an outcome of often widely differing views. Central banks are institutions that must act in the interests of the country as a whole, and they are able to do so precisely because they do not have a profit motive.

We should also bear in mind that our communication is not only with the market but with society as a whole. The "person on the street" is directly or indirectly affected by what the Bank does, and is therefore also interested in what it says and does. Here the role of the press is critical, not only for reporting directly what we have said, but also for interpretation, as the interpretation given by the press can become the conventional wisdom.

To contribute to journalistic excellence and a deeper understanding of economic and monetary policy the Bank has, for a number of years, sponsored the training of financial journalists at Rhodes University and the University of the Witwatersrand. We need to have an informed public in the sense that they should have a good idea of what to expect from central banks, and not to raise expectations of what a central bank cannot in fact do. Unfortunately, as I noted earlier, during the crisis the pressures on central banks have multiplied, as have the expectations.

George Akerlof and Robert Shiller, in their book *Animal Spirits*, identified five psychological factors that were important to understand animal spirits which, they argue, drive almost everything and are more than just confidence as measured by confidence indicators. They argue "that declining animal spirits are the principal reason for the recent severe economic crisis …" and see no clear indication that these spirits are yet revived. The news media are singularly lacking in any explanation for the recent resurgence of the world economy beyond the improvement in the leading indicators, such as stock market prices and retail sales numbers … "The five psychological factors are confidence, fairness, corruption and bad faith, money illusion and stories … (and) that human interest stories give vitality and emotional resonance to economic views that drive animal spirits …"

They use the example of the US TV show, The Apprentice, and how this story spread rapidly all over the world through local remakes during a time of economic expansion, with the substitution of a local tycoon or personality – as for instance in South Africa where this role was filled by Tokyo Sexwale. They go on to ask: "With such contagion around the world, during the boom, of such a motivational TV story, is there any reason to doubt that the contagion of stories has economic significance, or that there could be worldwide fluctuations in animal spirits? … The stories people tell are also stories about how the economy behaves …"

When we consider the above example of The Apprentice, what is not reflected is the question of power relations, how the power of the media is used to give voice to certain views, how this reinforces or reflects power relations in society. In The Apprentice what is also conveyed is the authority of the tycoon, and how the "boss" behaves: it conveys the power relations very clearly in the pay off line "You're fired!" The voice that is aired also determines the parameters of the debate, so we need to ask: where is the voice of the powerless? And what lessons about voice, power relations and responsibility have been learned from The Apprentice and the appalling revelations of the News of the World/Murdoch inquiry?

Therefore in conclusion before an audience of media professionals, is it not appropriate for each of us to ask ourselves: what is the story we tell, whose story do we tell, how do we convey the news, how do we impart information, what role do we play in creating an informed and knowledgeable citizenry, and how do we ensure that it is not our own goals and objectives that we project on a society hungry for information and a greater understanding of what is really going on.

Finally, to remind all present that later this year the Bank is introducing a new bank note, which has the image of Nelson Mandela on the front of all denominations, while the big five animal theme has been redesigned and retained for the reverse side of the notes. We will be conducting an extensive media campaign to ensure the South African public is aware of the new note, which will co-circulate with the current note, and is of equal value. We count on your support to help ensure an informed public, so that we protect the integrity of our currency.

Thank you for inviting me tonight, and for enabling an ongoing conversation in the very challenging times we live in.

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