# Paul Jenkins: Communicating Canadian monetary policy: towards greater transparency

Remarks by Mr Paul Jenkins, Deputy Governor of the Bank of Canada, to the Ottawa Economics Association, Ottawa, Ontario, 22 May 2001.

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I want, first, to thank the Ottawa Economics Association for your invitation to speak to you today. I welcome this opportunity to talk about an important aspect of the work of the Bank of Canada in conducting monetary policy – communications.

In the next few minutes I would like to discuss some of the factors that are central to monetary policy communications. I will touch on a few of the particular challenges we at the Bank of Canada face. And I'll conclude with a few words on the Bank's communications approach, including its role in the new system of fixed dates for announcing interest rate decisions.

### The trend to openness and transparency

Let me begin with a brief backward glance. It is not so long ago that central banks did little to let people know what they were up to and why. Indeed, in the conduct of monetary policy, little emphasis was placed on trying to explain the objectives of policy because those objectives were not clearly defined. Without clear objectives for monetary policy, central bank actions were generally not predictable. And the conventional way of thinking among central banks was that it was best to say nothing and let actions speak for themselves.

It is a different story today. Indeed, there has been nothing less than a sea change in the way central banks view the role of communications in monetary policy. What we have seen in recent years is a broad and continuing trend among central banks towards greater openness and transparency in the conduct of monetary policy. This trend has come about not because of any "fad" for public relations or for marketing a central bank's image. It has occurred because of fundamental changes in the way monetary policy is approached and conducted and the corresponding recognition that the effectiveness of monetary policy is improved through greater transparency. And to be transparent requires proactive and well-planned communication.

### Why communications has become so important for monetary policy

For the Bank of Canada, communications has become a strategic priority in supporting our goal of preserving a low and stable inflation environment. We believe that maintaining low, stable, and predictable inflation is the best contribution monetary policy can make to a productive, well-functioning economy.

An important step towards increased transparency, and thus towards clear and focused communication, was taken in 1991 when Canada adopted explicit inflation-control targets. The announcement of the targets clarified the objective of monetary policy and provided a nominal anchor for economic and financial decisions. (As you know, last week the government and the Bank agreed to renew the inflation-control target of a 1 to 3 per cent target range and a 2 per cent target midpoint.) The greater transparency of inflation targets has also anchored the Bank's approach to communicating what monetary policy is trying to achieve, our means of achieving it and our assessment of the state of the economy.

While the targets continue to define our inflation objective, conditions in the economy are constantly changing. Both international and domestic developments can affect the economic outlook in Canada. The Bank has to continually assess these changes and their implications for future inflation. If required, we take appropriate policy actions that are consistent with achieving the inflation-control target over the medium term. The role of communications is, therefore, to explain how and why circumstances have changed and to relate the Bank's actions to our inflation target and to the well-being of the economy.

I'd like to suggest to you that there are at least three important and related ways that good communications can help monetary policy be effective.

First, good communications helps put the Bank and financial markets on the same wavelength. That is very important because, generally speaking, monetary policy is more effective when financial markets understand how the Bank assesses economic developments in relation to our policy objectives. When we are all on the same wavelength, markets can anticipate, rather than simply react to, interest rate actions by the Bank.

If the Bank does a good job of keeping market expectations broadly in line with the direction of policy, there tends to be less volatility in financial markets and a smoother, more rapid incorporation of any shifts in policy into interest rates and exchange rates. In other words, effective communications improves the monetary policy transmission process and leads to responses in the exchange rate and in the term structure of interest rates that are more consistent with the Bank's intentions. This greater stability and predictability is in everyone's interest.

A second reason why communications has become so important has to do with the effect of public expectations and behaviour on the Bank's ability to meet our policy objectives. Improving public understanding and acceptance of what the Bank is trying to do increases the chances of success in achieving the inflation targets with as little economic disruption as possible. It is largely a matter of the credibility of the Bank's commitment to those targets.

Let me be more specific. If consumers, investors, workers, businesses, and governments believe that action will be taken to ensure that inflation remains close to the target, then they are more likely to make economic and financial decisions accordingly. Pricing decisions by producers and suppliers will reflect inflation expectations consistent with our target. Wage bargains between employees and employers will tend to be in line with the inflation target. The net effect will be a more stable macro-economic environment and greater success in keeping inflation low.

Keeping in touch with expectations also entails good two-way communication. The Bank consults Canadians in business, finance, and government across the country on a regular basis. By doing so we keep informed of economic developments and perspectives on the ground, and this contributes to our understanding of what is happening in the "real" economy.

A third reason why communications is important is accountability. As a public institution with a high degree of autonomy for the conduct of monetary policy, the Bank of Canada bears an obligation to account to Canadians for how well it is doing its job. An explicitly defined and agreed upon inflation target provides a clear basis for accountability. This clear basis for judging the Bank's performance is extremely important for credibility. But for the Bank to be fully accountable, it must provide the public with the information it needs to be aware of, and understand, the Bank's policy objectives, the factors we take into account in making decisions, and our progress in meeting our objectives. That is the job of communications.

**Challenges in communicating monetary policy**

Recognizing and understanding the importance of good communications does not mean the job is easy. In fact, being more open and transparent has created a wide range of communications challenges.

One of these challenges stems from the medium-term time frame in which monetary policy operates. When the Bank raises or lowers interest rates, it takes about 12 months for this change to have its peak impact on aggregate demand and about 18 to 24 months to fully affect inflation. In other words, when the Bank acts, it does so on the basis of assessing developments, gauging the impact on the economy and on inflation 1 to 2 years down the road, and taking action to achieve our inflation target over that horizon.

If the public is going to make informed economic and financial decisions, then it needs to understand and take into account the time frame over which monetary policy has its effects. Yet there continues to be a tendency to view Bank actions only as a short-term response to immediate events rather than in the context of medium-term trends and objectives.

Adding to this communications challenge is the fact that assessing economic trends in the future is not an exact science but rather a highly interpretive exercise. Unforeseen developments or "shocks" are always occurring, and there is always an element of uncertainty about the order of magnitude and persistence of these developments. Thus, what we say and communicate about the future has to be phrased in conditional terms. And if the picture looking forward is clouded by uncertainties, it is impossible for a central bank to provide financial markets and the public with a high degree of precision and certainty.

A second key communications challenge could be formulated as a question something like this: In becoming more transparent, how can the Bank best ensure <u>value</u> in what we communicate?

At the risk of sounding a touch glib, I would argue that, when it comes to monetary policy communications, "more" isn't necessarily "better." It is "quality" that is of greater importance in transparency than "quantity."

As I have already noted, monetary policy needs to be viewed from a medium-term perspective. Therefore, the Bank can provide substantive value by communicating what it sees as the key trends in the economy and inflation and how the conduct of monetary policy relates to these trends.

Usually it is the accumulation of information that gives understanding to these trends. For that reason, the Bank cannot, and should not, comment on every piece of new economic data or information that becomes public. But by transmitting our view of the larger trends in the economy, the Bank can promote better anticipation of the direction of policy.

Our concern about quality has also influenced how we approach the flow of information just prior to, and at the time of, our policy announcements. The Bank consciously refrains from making public comments on issues relating to monetary policy in the week before an announcement on official interest rates. This is a sensitive period, particularly for financial markets, and comments could easily be misinterpreted.

The other point I would stress about the quality of information relates to how the Bank arrives at monetary policy decisions. The decision-making of the Bank's Governing Council is a process of consensus building. Members of the Governing Council are full-time employees of the Bank who meet on a daily basis. In the two weeks prior to a policy announcement, there is a series of meetings at which information from several sources is presented by Bank staff and discussed. Out of this process a consensus is developed within the Governing Council on the appropriate policy decision. Therefore, what is of greatest value from a communications perspective is a clear statement of the substantive reasons for a policy decision. That statement is the press release announcing our decision.

Four times during the year, the announcement is supplemented two weeks later with the publication of our semi-annual *Monetary Policy Reports* (in May and November) and *Updates* to the full *Report* (in February and August). These publications, which are finalized as of the policy announcement date, elaborate in greater detail the Governing Council's assessment of the factors that shaped the interest rate decision.

Another challenge revolves around the fact that the Bank`s communications are with different audiences that may have different degrees of interest in what the Bank says and does.

The general public, for example, is generally interested in inflation, the value of the dollar, and whether or not interest rates are going up or down – those developments that have an impact on their daily decision-making.

Financial markets, on the other hand, are intensely interested in both the direction and the intricacies of monetary policy and tend to be highly sensitive to any Bank action or comment bearing on these issues. They scrutinize Bank publications and speeches by senior Bank officials for any shade of meaning about where monetary policy might be heading. This makes communicating monetary policy a difficult task, because some of the subtleties and complexities related to the direction of monetary policy simply can't be reduced to a few words.

The challenge is in tailoring messages that communicate as clearly as possible the Bank's assessment of the economy and the direction of policy, while bearing in mind the specific concerns and information needs of different audiences.

This challenge is all the more difficult when it comes to the media, an audience that is instrumental in whether or not we communicate successfully.

There are no two ways about it. The Bank relies heavily on the media to get our message to the public, whether it is via TV and radio, newspapers and magazines, or the various wire services that feed financial institution trading rooms as well as news outlets across the country.

We also recognize that the media act as a filter for what we say and often determine which of our statements will be reported. It is part of the media's job to interpret our decisions and perspectives and to comment on how they see the Bank executing its mandate. It is also their job to reflect the views of third parties on what we say and do. That is healthy for democracy, healthy for our accountability, and can be healthy for raising public awareness of monetary policy issues.

In this rather complex communications environment, it is squarely in the Bank's interests that the media cover monetary policy as fully and accurately as possible. And the chances of full and accurate reporting are enormously better if the media are well informed about monetary policy and the factors affecting what we at the Bank do. Bearing in mind my comments a few moments ago about the frequently complex and conditional nature of monetary policy, I don't underestimate the challenge – either for us or for the media.

For the Bank's part, we have taken a number of steps in recent years to strengthen our relations with the media and to furnish them with the information necessary for high-quality reporting and commentary. We now provide not only more information than in the past but more occasions when we explain information directly to the media and respond to their questions.

Thus, for example, we have instituted regular media briefings prior to the release of key Bank reports. We installed a special "lock-up" facility at the Bank to enable the media to read our releases and write their stories in advance of their official publication. We have increased the number of press conferences and media sessions given by the Governor and Deputy Governors.

The media tell us these changes have been helpful. But I would suggest that there is still some progress to be made to ensure that Canadians receive the accurate and insightful coverage of monetary policy they have every right to expect. For example, the media might assess whether investing more time and intellectual capital could strengthen and deepen its reporting and commentary on monetary policy issues. And there may well be additional things the Bank could do to promote better understanding of monetary policy. Indeed, we have been looking at the greater use of the electronic media to reach the public, and our new Governor has already done a fair number of interviews on radio and television. Our goal here is to continue the move to greater openness in Bank communications while at the same time being careful to stay clear of any short-run, market-sensitive issues.

We will continue to consult with journalists and reporters about this and other improvements that we might consider.

### The Bank's communications strategy – an evolving process

To this point, I've underlined why communications is important for effective monetary policy and some of the challenges we face in communicating a complex subject to a variety of interested audiences. Now I'd like to say a few more words about what we've been doing at the Bank of Canada to communicate monetary policy in an open and transparent way.

As I've already indicated, our overriding objective is to focus attention, debate, and understanding on the Canadian economic and financial situation and what it means for keeping inflation low and stable.

To do this, the Bank has taken a number of initiatives. In 1995, we introduced our semi-annual *Monetary Policy Report*, which in many ways has become the centrepiece of our communications strategy. It is the Bank's fullest interpretation of recent developments in the economy as well as our outlook for the medium term, the horizon over which monetary policy has its effects.

Between each *Report*, we publish an update of the Bank's views. Interspersed between these releases are speeches and press conferences by the Governor, speeches by Deputy Governors, press releases, and regional outreach activities, which have greatly broadened our audience coverage.

As part of our communications strategy, we have tried to schedule our publications and communications events throughout the year to achieve a regular, continuous, and integrated program of public communications. This permits us to communicate on a more continuous basis our evolving views on the economy and on the trend of inflation.

On the operational side, in 1994, we introduced an operating band for the overnight rate of interest to give greater clarity to financial markets about the Bank's desired rate setting. In 1996, we set the Bank Rate – the rate at which we lend to financial institutions – at the upper limit of the operating band. And in 1999, we set the target for the overnight rate as the midpoint of the band. Currently, we are moving to place more focus on the target for the overnight rate in our announcements since it is the appropriate policy rate for international comparisons. For example, our target for the overnight rate corresponds with the U.S. Federal Reserve's target for the federal funds rate.

We have also put a lot of emphasis on developing and maintaining our Web site. It gives the public at large direct access not only to our publications and speeches but also to more easily understandable information about the Bank and monetary policy. (By the way, I encourage you to take a look at our Web site at www.bankofcanada.ca. It was recently ranked second among 24 central bank sites reviewed by the London-based organization, Lombard Street Research Ltd.)

### Fixed announcement dates

Our most recent innovation to our strategy, launched on 5 December last year, is a new system for announcing decisions on official interest rates. Any change to the target for the overnight rate of interest is now announced on eight pre-specified or "fixed" dates during the year. On each date, a press release is issued, indicating the Bank's decision either to change rates or to leave them unchanged and giving a short explanation of the reasons for the decision. This approach replaces the former practice of only making an announcement if we changed interest rates and doing so without any warning to the public or to financial markets.

The new, fixed-date approach is an extremely important step for the Bank in implementing monetary policy actions. From a communications perspective, it provides a number of important benefits. First, it gives the public, the media, and financial markets the certainty of knowing exactly when the Bank will make an announcement on interest rates. This allows them to plan more efficiently and make more orderly assessments as each announcement approaches.

A second communications benefit of fixed dates is the increased emphasis they bring to the economic situation in Canada as the primary focus of Canadian monetary policy. We believed this would lead to increased commentary on Canadian economic circumstances and their implications for monetary policy during the period leading up to a fixed announcement date. That, in turn, would contribute to building public awareness of both economic developments in Canada and the role of monetary policy.

A third benefit is that fixed dates provide the Bank with a regular opportunity to put the recent economic and financial developments into a medium-term perspective. As I said earlier, this is important because the effects of monetary policy actions are usually spread over 1 to 2 years. The press release on each fixed date, together with the Bank's other communications vehicles such as the *Monetary Policy Report* and *Updates*, enables the Bank to position recent developments in terms of the underlying trends over this time horizon. If we communicate this successfully, there should ultimately be more public focus on the trends over time that are important to monetary policy and less reaction to near-term developments.

Finally, the eight new fixed dates increase the number of opportunities for the Bank to communicate its views on the economy. Whether or not there is a change in our policy rate, the analysis in the press release should stimulate a more frequent and continuous dialogue with key audiences and should generate more regular commentary among analysts and the media.

We now have the experience of four fixed announcement dates under our belts. While it is still early to draw conclusions, generally we are very pleased with the way fixed dates are working and with the positive reaction they have generated. We have already seen more focused public commentary on the Canadian economic situation, and that is extremely encouraging. With the benefit of further experience with the new approach and feedback from financial markets and the public, we will be able to assess what further improvements might be made. But we are more convinced than ever that this new approach will increase the effectiveness of monetary policy.

### Conclusion

To conclude, I want to emphasize that the Bank will continue to look at ways to build on the progress we have made in increasing the openness and transparency of monetary policy. Communications will play an increasingly vital and strategic role in helping achieve this further progress. It is a role that we at the Bank are extremely serious about. For in the final analysis, monetary policy is most effective when it is effectively communicated. Thank you.