Bandid Nijathaworn: Are there limits to transparency?

Remarks by Mr Bandid Nijathaworn, Deputy Governor of the Bank of Thailand, at the IMF Conference on Central Bank Communications, Mumbai, 23 January 2006.

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First, let me thank the IMF and the Reserve Bank of India for the invitation. It is a pleasure to be here in Mumbai. And I should also congratulate the IMF for putting up what seems to be another useful and successful seminar.

My contribution today is to speak on limits to transparency. Given the limitations of time, I want to begin by looking at the needs of central banks for limiting transparency, especially in the context of central banks' own operations. Then, I want to speak on the challenge facing central banks in designing appropriate disclosure policy. And finally, I want to share with you my thought on how to approach transparency in the context of monetary policy.

Transparency has now become an important policy aspect of central banking. Not only is transparency linked directly to the governance issue, but greater transparency also imparts important benefits to the effectiveness of central bank policies. In broad terms, three benefits from greater transparency are often cited.

<u>First</u>, greater information provided by the central banks allows market participants to accurately evaluate the behavior and the performance of central banks. This is most important for public organizations like central banks.

<u>Second</u>, financial markets tend to work more efficiently with greater transparency. This is because uncertainty is reduced as market expectations are formed using a more superior set of information.

And <u>third</u>, being more transparent also helps raise the quality of central banks' own works which directly contributes to enhancing their credibility.

However, despite the positive benefits, there are occasions when there would be arguments for central banks to go less than full transparency, especially with regards to their market operations. This is because transparency is not only about providing information as the academia normally assume. But transparency is also about how a central bank is being seen or being known in its operations in financial markets. Hence, for its operations to be effective, sometimes less-than-full transparency can be more efficient, for example, in the foreign exchange markets.

Therefore, from practical considerations, the rationale for limiting central bank transparency includes:

<u>First</u>, legal requirements and the risk of impinging on personal privacy, as well as for reasons of market or commercial sensitivity and public interest;

<u>Second</u>, the risk of compromising the decision-making process; for example, saying too much or giving out too much information about what went on in the policy meetings;

<u>Third</u>, too much information can also be tricky because of the risk of misinterpretation. This is because one cannot assume that all markets are efficient in processing the same information;

<u>Fourth</u>, in central bank operations, elements of surprise can be useful on occasion;

And <u>fifth</u>, central banks being what we are should reserve the right to act. This is to say central banks should always have room to act, especially in response to an unforeseen emergency situation.

So, given the benefits that central banks can gain from greater transparency and the rationale for having some limits, the challenge is to find the right balance in disclosure policy that maximizes the economic benefits of transparency while, at the same time, limits the unnecessary risks and provides flexibility to act when needed.

The second issue I want to speak on today is the challenge to central banks in designing disclosure policies. On this issue, I want to begin by saying there is no absolute level of appropriate transparency. This is to say appropriate level of transparency to a central bank is not firm or fixed but always changing, depending on the circumstances which include the capacities of the central bank to provide information, the demand for information from financial markets and stakeholders, and how much credibility does the central bank has. Such are the forces that eventually shape the extent to which the central bank should be transparent in the eyes of the public.

Another point about disclosure policy is that disclosure policy cannot be separated from the central bank's own communication policy. This is because data release by itself is mostly not sufficient. The central bank will need to communicate what those data mean and, on the basis of those data, what is the rationale for the central bank to pursue certain policies. In short, being transparent also means being able to explain one's own decisions and actions.

And the final related point about disclosure is that, despite the recent trend on transparency, with more and more central banks moving towards greater transparency, our research shows that there is still no clear convergence of the practice. Central banks continue to practice things differently, although in some areas the established practices are more or less uniform.

To illustrate this point, let me now turn specifically to transparency in monetary policy which is the heart of central banks' responsibilities and operations.

In monetary policy, there are six areas where transparency is now well established and is being practiced by most central banks. These are (1) stating clearly what the objectives of monetary policy are; (2) explaining clearly the framework of monetary policy and its operating procedures; (3) having regular economic data release; (4) making known clearly the decision-making process of monetary policy which includes who make the decisions, how often, the timetable of meetings, and the dissemination process to announce the policy decisions; (5) publishing timely economic reports to explain views on the economy and risks as well as the rationale for their monetary policy decisions; and (6) the readiness of central banks to communicate with markets either through the media and public addresses or appearing before public or congressional committees.

In my view, these are the core areas where transparency in monetary policy is most important and they are the areas that are being increasingly practiced by central banks around the world. The Bank of Thailand, if I may add, is transparent in all of these six areas.

As I noted, although the areas for transparency are well identified, the details and the practices adopted by central banks do differ and are not uniform.

For example, while most central banks would have low and stable inflation as an objective of monetary policy, practice differs on how that objective is defined. This is to say some central banks announce numerical inflation targets and some don't. This, of course, depends on the underlying monetary policy framework. In our case, the Bank of Thailand adopts inflation targeting as its monetary policy framework, so the Bank announces a numerical inflation target - that is core inflation to be kept between 0 - 3.5 percent averaging over a quarter.

Some central banks publish detailed economic and inflation forecasts to guide the markets about their understandings of the economies and the risks that the economies face. The others do this but not in great detail. On this, the Bank of Thailand is in the former group. We publish assessments of the economy, the economic forecast, and the inflation outlook in the form of a quarterly inflation report.

There is increasingly call for central banks to provide data ex post on their market operations and intervention. At this time, most central banks, I think, have not responded systematically to this aspect of transparency.

A number of central banks publish minutes and voting records of their monetary policy meetings with a lag, but the majority still don't. The main reason is the risk that doing so could undermine the decision-making process where frankness and openness are required. Having detailed minutes and voting records might encourage the attending members to read out their statements rather than to get involved in detailed discussions.

Because the practices differ, I said earlier there is not yet a clear convergence of the practice. Non-convergence of practice can be seen clearly from the current practice of the eight major central banks.

I want to end my remark today by sharing with you my thought on how to approach transparency in monetary policy.

The first is that transparency is not just a fad. It is something that will stay. And as organizations making public policy decisions, transparency is of most importance to central banks as a way of being accountable. Also, transparency is important to central banks for building credibility and for gaining public acceptance of their policy.

Second, in moving towards greater transparency, an approach based on sequencing or gradualism looks to me to be better and more efficient than a big-bang approach. The sequencing, in my view, should focus initially on building minimum critical components of core transparency, and then moving on to greater transparency in selected areas when ready. Along this line, the sequence could be first data dissemination, followed by establishing a structured and open decision-making process, then followed by publishing economic forecasts and then moving on to providing data on the central bank's operations. This is essentially the sequence that the Bank of Thailand has been following.

And finally, efforts to strengthen disclosure policy should focus on having a well-defined work process as well as capacity building. This is because, in the end, the abilities to explain our actions will be most crucial. Such ability rests solely on how good and how knowledgeable we are as central bankers. So, it links back to the needs for central banks to continue building our own capacities and capabilities both in economic research and in other areas of financial markets.

Let me stop here. I hope this brief remark has been useful to the seminar.

Thank you.