Jean-Pierre Roth: No news, good news - transparency and communication in monetary policy

Address by Mr Jean-Pierre Roth, Chairman of the Governing Board of the Swiss National Bank and Chairman of the Board of Directors of the Bank for International Settlements, at the Annual Meeting of the European Business Press, Zurich, 16 June 2006.

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Introductory remarks

Ladies and gentlemen, it is a great pleasure to address you here, on the occasion of your annual meeting. I would like to take this unique opportunity to talk about an issue which, in recent years, has strongly affected my job as a central bank's President and your work as journalists: transparency and communication in monetary policy.

Over the past two decades, central banks, especially in Europe, have undoubtedly be-come more transparent. Central bankers now regularly communicate their assessment of inflationary pressures to the public and go to great lengths to explain their monetary policy stance. Gone are the days when central banks argued that secrecy was an essential ingredient of an effective monetary policy. As a consequence, monetary policy decisions are no longer taken at irregular intervals or at weekends, in order to surprise markets on Monday mornings. This, of course, is fortunate for business journalists. You no longer need to spend your weekends worrying that you might have to suddenly start writing about a surprise policy intervention.

As you may have guessed though, the main reason for central bank transparency is not to make your weekends more relaxing. Central bankers today pursue a policy of broad information because we believe that transparency helps us fulfil our mandate. We are convinced that monetary policy is most effective and least disruptive if it is predictable: no news on monetary policy is good news.

In the following, I would like to discuss why, today, central bankers think transparency is crucial for a successful monetary policy and how the Swiss National Bank attempts to achieve transparency in practice. I shall then debate the limitations of what transparency Finally, I would like to reflect upon how transparency in monetary policy may affect the relationship between you, the journalists, and us, the central bankers.

1. The case for transparency

At the Swiss National Bank we see three main reasons to be transparent about our monetary policy.

The first reason is that we count on transparency to enhance the **effectiveness of our monetary policy**. In the public eye, central banks may be viewed as almighty. The plain reality is, however, that our open market operations only have a direct influence on current short-term interest rates. Economic activity and thus future price developments are, however, determined primarily by the shape of the yield curve, i.e. by the expectation of future monetary actions. Transparency about how we judge future inflationary pressures enables us to guide expectations about future short-term interest rates and thus also long-term interest rates.

The second reason is that transparency reduces the inevitable **uncertainties** related to monetary policy implementation. If markets know how we judge future inflationary pressures and how we may react to these, they can better predict our future monetary policy. Improved predictability of monetary policy leads to fewer painful surprises in the economy. Moreover, less uncertainty about monetary policy reduces both risk premiums in financial markets, and financing costs.

The third rationale for central bank transparency is public and political **accountability**. Central banks are mandated to act in the interest of their country, usually by maintaining price stability. This can imply unpopular decisions, which is essentially the reason for central bank independence. . Central banks should thus be free from public and political pressure. But it is obvious that some mechanism must be set in place to ensure **accountability** of independent central banks. Transparency about monetary policy is essential to central bank ensure accountability. However, transparency in itself is not enough. The statements made by central bankers must be accessible to the public and must be subject to scrutiny. Here, a critical press has a very important role to play.

2. Communication of monetary policy by the Swiss National Bank

In order to improve monetary policy effectiveness and enable public accountability the Swiss National Bank started to regularly explain its monetary policy decisions to the public already in the 1970's. Our first press conference was conducted in November 1974, shortly after the collapse of the Bretton-Woods fixed exchange rate regime. Moreover, from 1975 onwards we published yearly goals for the growth of monetary aggregates in order to guide market expectations of interest rates and inflation.

With the introduction of our new monetary policy concept six years ago, we took three specific measures in order to further enhance our transparency:

- First, we have defined consumer price inflation of less than 2% as our **quantitative goal for price stability**. This step has enhanced the predictability of our monetary policy because market participants know exactly what we want to achieve. They can expect monetary policy to be tightened if we believe that inflation could exceed 2%.
- As a second step, we now regularly publish a **medium-term inflation forecast**. This forecast helps market participants to predict future monetary policy because they not only know our goal for inflation, but also how we judge future inflationary pressures.
- Our third step towards more transparency has been to explicitly communicate our **operational target**. We announce our target as a 1% band on short-term interest rates, that is, on the three-month Libor. We thus regularly offer market participants a quantitative indicator of changes in our monetary policy stance.

Our experience with the systematic communication of our monetary policy during the past six years has been very positive. Market predictions of monetary policy measures have been accurate, leading to lower volatility in financial markets and improving the effectiveness of our policy measures A prime example of this is the most recent increase in our operational target in March 2006. An analysis of interest rate movements shows that the increase of our operational target by 25 basis points was almost fully anticipated by financial markets prior to the announcement. Contrary to what many believe, a central bank does not lose any prestige in seeing its policy correctly anticipated by the markets. It is just proof of a well-understood monetary strategy.

3. Credibility - words are not enough

In Switzerland, the systematic communication of monetary policy has had the desired effect of getting market participants to adapt their expectations well before actual policy interventions are made. Does this mean that the Swiss National Bank now only has to indicate its intentions in order to influence interest rates? Or as some academics and practitioners have posed the question: can central bankers now replace open market operations with "open mouth" interventions?

Considering the recent tightening of monetary policy in Switzerland, one might be tempted to agree that open mouth operations are sufficient to move interest rates. After all, short-term interest rates rose long before an increase in the operational target was announced or before we raised the actual interest rates on repo transactions. However, this interpretation of the data ignores one crucial issue. Interest rates moved upwards before the Swiss National Bank adapted its operational target or its repo rate because financial markets trusted that we would increase interest rates. Given our objectives and our previous track record, it was credible that we would hike interest rates in the given economic environment.

Central bank transparency can only improve monetary policy effectiveness if it increases the predictability of future monetary measures. I would like to emphasise that predictability relies not just on information and the communication of intentions, but also on whether the public trusts a central bank to realise these intentions. Central bankers can thus only benefit from transparency if their statements about future monetary policy are credible. Ultimately, we know that our words must be matched by our actions.

4. Transparency and press coverage of monetary policy

Ladies and gentlemen, central bank transparency yields economic benefits because it enhances monetary policy effectiveness and reduces uncertainties. Moreover, in a de-mocratic state, transparency is essential if independent central banks are to be held accountable by the public. I am therefore convinced that central banks around the world will continue to pursue a policy of openness for a long time to come. This leads me to an important question for all of us here: how will transparency about monetary policy affect future relations between the press and central banks.

Does central bank transparency mean that future monetary policy will be boring, and that press coverage of central bank interventions will become obsolete? Looking at your coverage of our policy one might be inclined to think so. Between 2001 and 2005, for example, the Swiss National Bank was mentioned three times less in the Financial Times than in the period 1996 to 2000. However, let me emphasise that more transparency does not mean that monetary policy will always be simple to predict. Remember that the inflation forecasts published by central banks are always based on expectations of future economic developments. Hopefully, these expectations will be accurate most of the time. However, during certain periods of the economic cycle, particularly at turning points, our expectations will be prone to correction. I am therefore confident that, despite transparency, there will remain some news to report about monetary policy.

I do believe, however, that central bank transparency may change the nature of media reports on monetary policy. In the old days of secrecy and unexpected monetary interventions, journalists obviously debated the objectives of central bankers and what this meant for the future. With increased transparency, such discussions have become obsolete, as objectives seem to be clear and future policy is easier to predict. In return, central bank transparency now gives journalists the opportunity to question the consistency of our monetary policy decisions with our stated objectives. This leads me to believe that, in future, media coverage of monetary policy may concentrate on scrutinising the congruency of our actions with our goals, rather than debating about what central banks are trying to achieve. As a central bank governor, I would certainly welcome such a development.

After all, the credibility of our monetary policy ultimately depends on whether the public believes that we match our words with our actions.