Transparency and Communications in Modern Central Banking
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It is a pleasure for me to take part in this event and to have the opportunity of highlighting the importance of communications in modern central banking. Journalists play a fundamental role in transmitting our messages to the general public and that is why we are particularly interested in communicating with you and making ourselves understood to the best of our ability.

The time when central banks were opaque has passed. Today, transparency is the key to satisfying the demands that democratic societies make on autonomous institutions like central banks and to achieving monetary policy efficiency. So I would like to talk about transparency with a special focus on monetary policy.

Why the need for transparency?

In recent decades, central banks have become increasingly more transparent. For many reasons, which I will not go into today, they have moved towards a greater degree of autonomy in the conduction of monetary policy. Central Banks have been given operational independence and are able to exercise monetary policy using technical criteria and for the medium term. Therefore we have the first reason for central banks to be transparent: in a democratic regime an autonomous institution whose decisions have important implications for national welfare must display its legitimacy.

In the case of Chile, this duty to impart information is stipulated in the Central Bank’s Constitutional Organic Law which states that once a year the Bank must inform the President of the Republic and the Senate about its deliberations and developments. This takes place in September when the Central Bank Board makes its Monetary Policy Report to the Senate. Nevertheless, the Central Bank of Chile goes beyond this requirement and reports not only to the Senate in September but also presents a monetary policy report to the Senate Finance Committee in January and again in May. The same happens with the Financial Stability Report which is published in January and June each year. Similarly, the Bank gives an account of its management of international reserves once a year as part of its Annual Report.

However, this is not enough. The legitimacy of the Central Bank is upheld by direct, open communication with the general public and so these documents are put up on the Bank’s website at the same time as they are being presented to the Senate. Moreover, the Bank issues other reports, communications, minutes, specialised studies and statistics, all of which are available to the public. There are also press conferences and interviews with Bank boardmembers and staff.

The time when the workings of central banks was something complex and mysterious has also passed. We want the community to understand our work since it consists of
providing a public good - stability - which enables the country to progress. It is our concern that people no longer consider us a bunch of technocrats engaged in incomprehensible activities.

Another important reason for transparency has to do with the effectiveness of monetary policy. In recent years, there is a growing consensus towards the idea that monetary policy is better when it is carried out with clarity and predictability and is not a source of speculation and instability. To that end, the monetary authority must communicate clearly its vision of how the economy is working and how monetary policy decisions affect inflation.

With regard to Chile’s inflationary targets, we aim at centering on 3%, within a range of one percentage point either side. However, inflation cannot be controlled in the short term so we implement our policy in such a way that the projected inflation in two years is 3%. This requires high and constant degrees of transparency and communication, as I will go on to discuss.

**Transparency in inflation targeting**

In the past, when monetary policy was implemented in a different way, less information was required. For example, when there was a fixed exchange rate, the public only needed to look at the exchange parity each day to know whether targets were being met. Similarly, if a central bank bases its monetary policy on a certain monetary objective, the public only needs to check the way the figures for that particular aggregate are going to be sure that the objective is being accomplished.

However, in the context of inflation targets, where this variable is not controllable in the short run - and, as we are currently witnessing, it is subject to many shocks - it is important to monitor to what extent targets are met and for that it is not enough to simply monitor inflation figures since the scheme itself allows for deviations. The Central Bank must report these deviations and explain what is its strategy to correct them.

In an ideal world - without uncertainty and where all agents have the same information and also the possibility of protecting themselves from any contingency - transparency would be unnecessary. However, it is a good exercise to ask oneself what are the frictions that require communication, beyond being accountable to the state powers. Friction in this case is the lack of information market participants have about the Central Bank so transparency is fundamental to generating credibility and credibility is at the heart of a good monetary policy.

There are two kinds of asymmetries of information that require communication: one is the uncertainty about the preferences and objectives of central banks and the other is the uncertainty about the central banks’ technical ability to achieve their target. By justifying to the public the decisions they are taking, central banks enhance their credibility.
Moreover, decision-making is improved by ensuring coherence between the decision and the communication and this obliges central bankers to profoundly reflect upon and evaluate their decisions thereby improving their monetary policy results. Thus we can claim that greater transparency has led to better economic performance.

As we see in Chile, there is a lot of talk about the decisions and the scenarios of the Central Bank and this is good because it strengthens credibility and keeps authorities committed to their objectives, not only at the moment of communicating but also at the moment of adopting those decisions.

Some reasons for the effectiveness of monetary policy are reinforced by communication with market participants and by some degree of predictability in the Central Bank’s conduct of its policies.

Monetary policy affects inflation because of its effects on spending (consumption and investment) and on financial asset prices. The Central Bank controls short-term interest rates but these have only a limited bearing on the economy; financial market participants base their decisions on the whole rate structure. Investment, for example, is fundamentally guided by long-term rates. Nevertheless, expectations about the course of short-term rates naturally have some bearing on the long-term rate and therefore do influence the whole rate structure. A transparent central bank affects the market’s anticipations by providing market participants with the information on which they base their vision of the likely course of inflation and monetary policy actions. So we see that expectations about the evolution of monetary policy contribute to its effectiveness.

**The Central Bank of Chile’s Communication of Monetary Policy**

Our two main vehicles for making our objectives known are the quarterly Monetary Policy Report and the twice yearly Financial Stability Report.

I would like to describe in more detail our communication of monetary policy. The content of the quarterly report is only a part of that communication. The preparation that leads up to its publication is a vital part of our work, demanding great dedication, discussion, interaction and reflection on the current state of the economy and the outlook for inflation. The Board and staff meet at least six times in the course of five weeks and there are presentations of special topics, any amount of bilateral meetings and draft reports are revised and discussed at length prior to publication. This means that in this process the boardmembers form a very clear opinion about how monetary policy is and how it should progress.

This kind of reporting was introduced by the Bank of England in 1993 and is common practice with central banks who set inflation targets. Today a great number of banks publish inflation reports and in a survey carried out by Fracasso et al in 2003 our Monetary Policy Report was classified in 5th place out of a sample of twenty such reports, the Bank of England’s being judged the best.
To provide a basis for discussions on monetary policy, the Board decides which are the key variables of the most likely economic scenario. The projections for these variables derive from sources considered to be the most realistic and widely accepted. For example, the outlook for world growth is based on the Consensus Forecast and the International Monetary Fund’s projections published in its World Economic Outlook. The outlook for commodity prices generally follows the futures market prices. Of course, these projections are imperfect - all projections are inherently uncertain - and the Board places particular emphasis on the risks and threats that may cause deviation from the basic scenario. Thus while making the basic scenario as realistic as possible, the important discussion centers on analysis of the deviations from it and, above all, what are the implications for our monetary policy and coherence with our inflationary targets.

To make this basic scenario more useful, we need to consider not only the external economy but also discuss the outlook for the key variables of our own economy, particularly exchange rate and interest rate.¹

To project the path of exchange rates, we use the parity with interest rates, that is, the exchange rate varies according to interest rate differentials. If the domestic interest rate is lower than the international interest rate (adjusted for risk premiums), the exchange rate can be expected to go down. Apart from this, we have to make some assumption about where the exchange rate will go in the long run. For this we suppose that if at the moment of making the forecast the real exchange rate is coherent, within a reasonable margin, with its long-term fundamentals, this value will be maintained in the long run. On the contrary, if it is deviated, we suppose that the exchange rate will converge on values coherent with the long term.² In this way, with interest rate parity and certain assumptions about the distant future it is possible to have a complete outlook for the exchange rate.

I must point out that in a floating exchange regime, this is a working assumption made only to provide a model coherent with projections, even recognising that the disclosed interest rate parity has little empirical value. In any case, as our experience early this year has shown, a significant deviation from this path can have important implications for the course of monetary policy. At the beginning of the year, it was thought that rates could go up in the first quarter. However, the Board considered that the downward pressure on inflation generated by a pronounced appreciation of the peso relieved pressure on monetary policy.

One aspect which has received much attention in monetary policy practice and theory is the supposed interest rate used in making projections, because this is the instrument used

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¹ For further details on projection models and as an example of transparency see Banco Central de Chile (2003). Also Banco Central de Chile (2007) updates the Board’s vision of monetary policy and its price stability objective.

² Caputo, Nuñez y Valdés (2008) presents the various models usually used to evaluate the real equilibrium exchange rate.
by monetary policy. It is therefore an assumption about the future conduct of the Board itself.

When we began publishing the Monetary Policy Report at the beginning of this decade, like many other central banks we worked on the assumption that the monetary policy rate would remain constant for the period of the projection horizon. Even though this was not wholly plausible over a horizon of a couple of years, it did seem to be not far off reality since the monetary policy rate was esteemed to be around its neutral level.

However, this working assumption became extraordinarily unreasonable when, towards the end of 2002 and early 2003, the monetary policy rate fell well below its neutral level. That is why, since that time we have taken as a working assumption a monetary policy rule that adjusts the interest rate in order to meet the target. \(^3\) This does not involve a commitment to the future rate path but it serves as an approach to discussion. We communicate this path by comparing it (saying it is higher or similar, etc) to the implicit path seen in the forwards curve and the expectations and in general we indicate what this means in terms of possible rate changes during the year.

For example, in the latest Monetary Policy Report we stated that “in the coming quarters the monetary policy rate will follow a similar path to the one implied by the various measures of private sector expectations taken in the two weeks prior to the statistical cut-off for the Report” and in the presentation to the Senate this was clarified in more detail by stating that “by the end of the year the monetary policy rate could lie in the range of twenty-five basis points more or less than its current level.”

In practice, and only two months after that presentation to the Senate, the interest rate has gone up one hundred basis points. In the Board’s opinion, this is necessary to prevent the latest news on inflation - both international and its run through to some domestic prices - from delaying the adjustment of inflation to its proper level within the policy horizon. The anchor for these decisions was the basic scenario on which the May Monetary Policy Report was drawn up.

Publication of the Monetary Policy Report is reinforced by communication on the content of our monthly monetary policy meetings in which we generally refer explicitly to the basic scenario and three weeks after each meeting takes place we publish the minutes containing the boardmembers’ discussions which again frequently refer to the basic scenario.

Evidence shows that financial markets are much more sensitive to information in the few days prior to a monetary policy meeting (Ehrmann and Fratzscher, 2008) and, at the same time, any comment that is misunderstood or confused could influence the position of someone in the meeting. For this reason we have a self-imposed period of silence, or

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\(^3\) See Woodford (2007) for recent discussion of the alternatives and coherence with a framework of inflation targets implemented through inflation forecast targeting.
purdah, in those days. This allows us to act with greater independence during the meeting and it reduces the risk of unsettling financial markets.

Are there limits to transparency? The answer is definitely yes. In every democratic society, transparency is a duty. But the limit is to what point an excess of transparency might limit the Bank in achieving its objective which is price stability. For example, we could televising live the monetary policy meetings but that would restrict the open, frank dialogue that goes on. Besides the discussions could be misinterpreted because they involve much technical jargon and judgements. I imagine that these same reasons prevent court hearings from being broadcast live.

In other words, since context determines conduct, an excess of transparency can limit the freedom with which we discuss and express our judgements, thereby undermining the capacity to make appropriate decisions on monetary policy. The more transparent, the more cautious boardmembers will be in pronouncing their judgements. That is why we have decided not to reveal boardmembers’ names in the minutes, so as not to inhibit an open, technical and independent discussion. In the pursuit of monetary policy effectiveness and predictability, we feel that the discussion itself is more important than names. A recent study by Meade and Stasavage (2008) compared the Fed’s Federal Open Market Committee discussions before and after 1993, at which time it was decided to publicise the transcript of the meetings 5 years after they had been held. The study concluded that knowing the proceedings were to be made public had reduced the number of challenges to the Fed chairman, at that time Alan Greenspan.

In general, transparency and its limits depend chiefly on the characteristics of the Board. For example, at one extreme we have the European Central Bank which does not keep minutes and dissent is very limited and at the other extreme we have the Bank of England where each boardmember has individual responsibility. Chile, like the United States, takes an intermediate stance. That’s why Blinder says, there is no “one-size-fits-all” approach.

Communications Policy

The Central Bank website carries a document called “Communications Policy” which specifies the principles and norms governing the Bank’s communication with the public. It states that the Bank communicates with the public by way of official notices and publications, minutes, previously announced public conferences, interviews or public declarations made by boardmembers. It also says the the Governor is directly responsible for all the information the Bank puts out, except for whatever the individual boardmembers might publish or say in public.

See Blinder et al (2008) for more details on communication in central banks and relevant references.
At the same time, the policy says that the Bank must publish all information or resolution relevant to the market as soon as it has been validated, thus obliging itself to give out all market-sensitive information as quickly as possible.

Whenever a boardmember or Bank executive gives a talk with information that could be relevant for the market, it is published on the website. Any talks or public presentations given by the Governor are put on the web as soon as they begin so that the general public has access to the information at the same time as those present. In my own case, and so that there is no discrimination between those who attend the presentation and those who do not, I leave a printed text of my speech which may not always be easy but it ensures a precise account. For my listeners, this is useful to their work and besides avoids the old excuse “I was misinterpreted” which may occur but in most cases is the fault of the speaker. Not all presentations are accompanied by the printed text in which case your job is to pick up on the fundamental messages and the speaker’s job to know how to best transmit them.

This communications policy requires a fluid relationship with the press. We can hardly amplify our messages if we do not have access to the media. We have a Communications Manager who advises the Bank’s boardmembers and executives on the intricacies of this relationship with the press. It is a complex relationship because it has to be carried on within the limitations imposed by the fact that we are a technical institution and our messages are highly sensitive for the market and for the general public.

One principle we rigorously uphold is that all information that is the product of a Board decision or resolution is communicated simultaneously, which means that no media channel can obtain it exclusively. There are strict internal rules on this matter and all contacts with Bank executives and staff must pass through the Communications Management before following the corresponding course.

We are not prolific in giving interviews, declarations or press conferences. We speak little, maybe less than the press would like and, although some of you might disagree with me, we try to maintain equanimity in our dealings with the media.

Just as the press requires us to be transparent, opportune and rapid and to use clear language, we must also stress the importance of the media vis à vis economic agents. We certainly do not ask you to restrict or limit the information, nothing could be further from the spirit of free speech we adhere to, but we do beg you to be rigorous in your reporting. Overinterpretation of decisions made by the Bank or overemphasis of transient economic indicators that do not mark a trend are situations that regularly influence public feeling and even behaviour. It only remains to me to recommend professional rigour and an adequate appreciation of the evolution of the economy, which are the same demands we at the Bank make upon ourselves.
Chile requires a specialised press that looks at economic events through the perspective of time and avoids being led away by sensations or climates. The economy progresses in long, slow cycles even though the day-to-day events may at times seem hectic.

We have seen tremendous progress in the Chilean economic press. The specialised journalists have played an outstanding role in contributing to a better informed society, better equipped to make its decisions. As in all fields, there is always room for further improvement. From our side, we are always available to contribute to explaining or advising on complex phenomenon.

Final Comments

I would like to finish with some comments on a matter that has concerned me for some time which is, on what subjects a Central Bank boardmember can talk, and in particular the Governor of the Bank who is the official spokesman. There is no restriction but there is a practical limit which is that no boardmember would like to spoil his professional and communicational reputation by speaking without well-founded arguments. It is true that the Bank has a limited mission but it has an excellent group of economists. For example, at the request of the Senate Financial Committee, studies have been carried out at the Bank on the long-term growth of the Chilean economy and both myself and my predecessor have written articles on the same (Corbo and Tokman, 2007; De Gregorio, 2008). We could believe it is possible to speak and to carry out research on relevant topics as long as we do not stray far from our fundamental task. A few weeks ago, Ben Bernanke spoke on the challenges of health reform in the United States (Bernanke, 2008) and ten years ago Alan Greenspan spoke on income distribution (Greenspan, 1998).

Just as the Central Bank asks that its autonomy is respected, which is far from not accepting criticism, we the Bank must also respect the decisions of other institutions. Here the balance is certainly tenuous. In any case, as a policy, the Central Bank at the moment of making a decision and defining scenarios takes what happens in other spheres of national life as a simple fact.

There is no clear rule, but there are principles. In the first place, the Central Bank must be rigorous in referring to all matters that have macro impact and consequently condition its actions. Secondly, when the connection is not so straightforward, we must be particularly cautious, especially when politically controversial subjects are involved. The Central Bank is a technical and autonomous institution and must take great care that the messages it puts out are not used politically. There are some very important subjects requiring discussion in our country, such as educational reform, but it would not be prudent for the Bank to be affected by approaching any matter in an inadequate or inopportune way. Even more complex would be the decision to discuss a tax reform that changes the composition of taxes or a labour reform that alters the dynamics of the economic cycle. Subjects like these have enormous implications for economic efficiency but they also evoke tremendous political passion.
Since there are no clear rules, and I have no defined position on this matter, I can offer two popular recommendations that I tend to follow: “nothing can be rejected out of hand” which allows an ample degree of flexibility and “if in doubt, don’t do it”, which is the best advice to be prudent.