

CENTRAL BANK COMMUNICATION AND MONETARY POLICY CREDIBILITY

BY

PROF. PETER QUARTEY
(HEAD, DEPT. OF ECONOMICS, UG)



UNIVERSITY OF GHANA

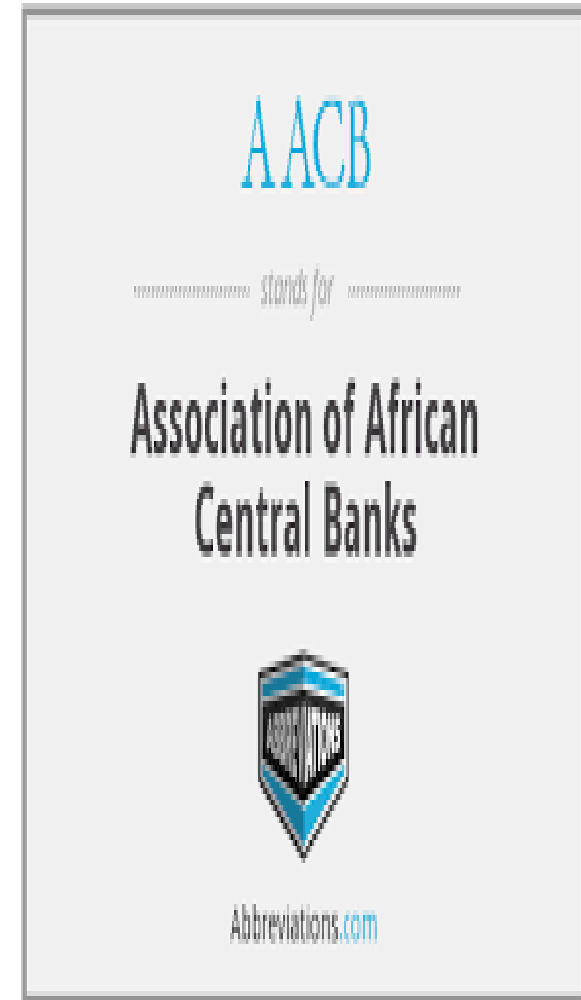
COLLEGE OF HUMANITIES

INSTITUTE OF STATISTICAL, SOCIAL AND ECONOMIC RESEARCH (ISSER)



OUTLINE

- ❑ Introduction
- ❑ Effective communication strategies
- ❑ Central bank communication and monetary policy credibility
- ❑ Communication and Monetary Policy Credibility in Ghana
- ❑ Conclusion



1. INTRODUCTION

- ❑ Effective monetary policy depends critically on its transparency and credibility
- ❑ Transparency is achieved when commitment to monetary policy goals are clearly stated. Eg. Low Inflation or Price Stability
- ❑ Note: Rules vs Discretion; Credibility vs Flexibility arguments



1. INTRODUCTION

- ❑ Until a decade ago, conventional practice within central bank circles has been to say as little as possible and say it using technical jargons
- ❑ However, increased communication and transparency are essential for effective monetary policy
- ❑ Effective communication is necessary because: (i) it provides democratic legitimacy to independent central banks (ii) it enhances the effectiveness of monetary policy (iii) ensures efficient functioning of the economy
- ❑ So, how do we achieve optimal communication to ensure that monetary policies are effective and credible?



2. EFFECTIVE COMMUNICATION

- ❑ Effective communication is more than a description of facts
 - It is largely about developing a strategy for transmitting a specific message
- ❑ Increasingly, central banks clarify their monetary policy framework and of policy goals
- ❑ Furthermore, they generally inform the public about the macroeconomic models underpinning their economic policy analysis
- ❑ The information are provided to
 - Financial markets (banks and non-bank financial institutions)
 - Public at large (government, investors, development partners, civil societies)
- ❑ This is done to make them increasingly familiar with the way central banks think and operate
- ❑ Thus, communication has become a vital/necessary functions of central banks

2. EFFECTIVE COMMUNICATION

Definition:

- Effective Communication Strategy: A **holistic planning approach** to engaging an **audience** to ensure greater **effectiveness**
- Universally accepted communication strategy has become a **holy grail**
- The most important part is setting **OBJECTIVES**
- Requires logical connection between communication objective and overall goal

2. EFFECTIVE COMMUNICATION

- ❑ **Central Bank communication** is the provision of information by the Bank to the public regarding:
 - ✓ Objectives of monetary policy
 - ✓ The monetary policy strategy
 - ✓ The economic outlook
 - ✓ Outlook for future policy decisions
 - ✓ Exchange rate interventions (via occasional statements)

- ❑ **Modern view of monetary policy is the management of expectations**
 - ✓ The ability of a Central Bank to affect the economy depends critically on its ability to influence market expectations (Reinhart et al, 2004)
 - ✓ Intermediate and long-term rates depend mostly on the public's expectations of future central bank policy

2. EFFECTIVE COMMUNICATION

- How much to be spent on communication?
- Communication budget and communications objective should be inextricably linked
- Need to be specific about the objective
 - ✓ Are we trying to change behavior or expectations?
 - ✓ Are we enforcing existing attitudes or trying to change people's mind?

2. EFFECTIVE COMMUNICATION

□ TARGETING

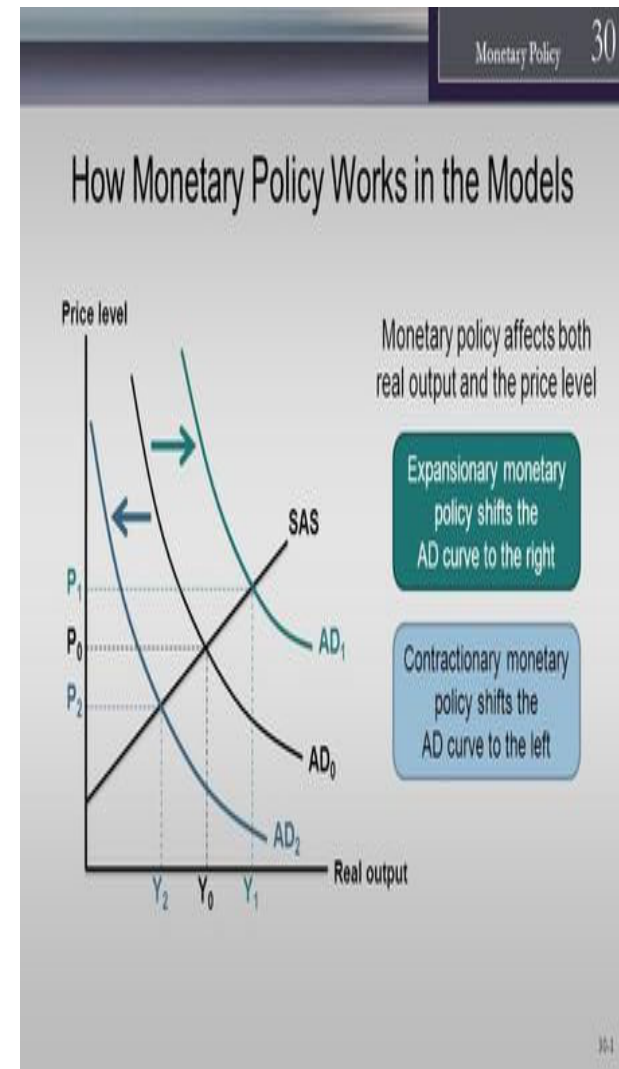
- Qualitative and quantitative research is key to understanding the target audience
- Effective communication strategy must be more richer and carry vivid description to the understanding of the targeted audience

Ways of Defining Audience

- Intermediaries
 - ✓ wholesalers, retailers, agents, brokers, professional advisors, opinion formers
- User Types
 - ✓ frequent, loyal, non-user, infrequent, heavy, medium, light, occasional
- People's Lifestyle
 - ✓ Keen on value for money, gamers, brand lovers, brand associated with charities
- Geo-demographics

3. CENTRAL BANK COMMUNICATION & MONETARY POLICY CREDIBILITY

- ❑ Good Communication enhance **policy effectiveness** by influencing expectations and **minimizing uncertainty**.
- ❑ Inflation expectations determine wage and price setting with its associated effects on output and employment
- ❑ Expectations about interest rates affect investment and consumption decisions.
- ❑ Expectations about exchange rate movements affects imports and exports as well as prices of goods and services
- ❑ Communicating its policy objectives ensures that price expectations are anchored to its price stability objectives.



3. CENTRAL BANK COMMUNICATION & MONETARY POLICY CREDIBILITY

- ❑ Effective central bank communication helps the monetary authorities achieve its objectives by enhancing its understanding of the markets as well making the public appreciate its policy aims
- A comprehensive and timely information is key. Not necessarily “more information” but Quality information
- ❑ Timely announcement of policy decisions could be beneficial to policy makers and the private sector
 - ✓ Since the private sector (**Engine of Growth**) gets access to more information
 - ✓ No **information asymmetries** between monetary policymakers and the private sector

3. CENTRAL BANK COMMUNICATION & MONETARY POLICY CREDIBILITY

□ Monetary policy effectiveness

- With **ineffective communication** the public rather **learns about the economy**.
 - ✓ When the public rather estimates the central bank's reaction function, the economy may not converge to the rational expectations equilibrium (Bernanke, 2004)
 - ✓ The feedback effect of learning on the economy can lead to unstable or indeterminate outcomes—which effective communication by the central bank can help to avoid (Eusepi and Preston 2007)
 - ✓ Various studies find that financial markets react to information on the outlook that central banks provide (Andersson, et al, 2006)
 - ✓ transparency reduces private sector uncertainty about the monetary policymaking process
 - ✓ helps the private sector to better forecast the settings of the policy instrument and the effects on inflation

3. CENTRAL BANK COMMUNICATION & MONETARY POLICY CREDIBILITY

□ PROMOTES INVESTMENT

- Apparently, investors update their own views in response to the information conveyed by the Central Bank.
- Private agents attach special credence to the economic pronouncements of their Central Banks (Donald and Sack, 2004)
 - ✓ Especially if the bank has established its *bona fides* as an effective forecaster.
- Public disclosure could facilitate CB's efforts to improve information quality so that it can withstand public scrutiny.
 - ✓ The MPC press releases could stimulate CB to engage in a high quality policy discussion
 - ✓ Publication of CB forecasts could induce the Bank to produce first rate macroeconomic projections.

3. CENTRAL BANK COMMUNICATION & MONETARY POLICY CREDIBILITY

□ EFFICIENT MACROECONOMIC MANAGEMENT

- **Rational Expectation:** an increase in inflation may lead the public to revise its estimate of long-run average inflation upward, which, in turn, raises actual inflation.
- CB communications influence expectations of future short-term and long-term rates and other financial-market prices
 - ✓ These prices, in turn, influence such macro variables such as inflation and output

4. COMMUNICATION AND MONETARY POLICY CREDIBILITY IN GHANA

The overriding goal of monetary policy in Ghana is price stability

Bank of Ghana law (2002), act 612. section 3(1) stipulates

- ✓ “the primary objective of the bank is to maintain stability in the general level of price”
- ✓ The law gives a clear mandate to BoG to pursue inflation-targeting

It is envisioned in the BoG Law that the implementation of sound monetary policy

- ✓ Creates enabling macroeconomic environment,
- ✓ For promoting of sustainable economic growth,
- ✓ And poverty reduction



4. COMMUNICATION AND MONETARY POLICY CREDIBILITY IN GHANA

Communication Strategies:

- ❖ Publications
- ❖ Website
- ❖ Press Conferences
- ❖ MPC Meetings
- ❖ Media Engagements
- ❖ Presentations and Representations at Meetings



4. COMMUNICATION AND MONETARY POLICY CREDIBILITY IN GHANA

Outcomes:

- ❑ Provided clear guidance for market participants to form expectations about inflation, exchange rate, exchange rate etc
- ❑ BoG is able to obtain feedback from market participants about how long-term inflation expectations react to fluctuations in actual inflation. Eg. Composite Index of Economic Activities Survey
- ❑ Improvement in the Predictability of market participants in anticipating next BoG policy decisions. Eg. Information on GDP growth, inflation, exchange rate enables us predict the policy rate
- ❑ Single Voice – Less divergent communication from the bank has enabled financial markets anticipate future monetary policy decisions and minimized the degree of market uncertainty

5. CONCLUSION

- ❑ Effective communication is vital for building the credibility of Central Bank policy
- ❑ Monetary policy credibility help promote macroeconomic stability, investment, and growth
- ❑ Monetary policies credibility requires CB needs to be:
 - Autonomous
 - Less variable in policy signals
 - Transparent
 - careful falling into time inconsistency trap
 - Allow some level of predictability
 - Maintain stability in policy strategies
- ❑ Managing the double sword edge of communication by providing quality information not quantity

5. CONCLUSION

- The following recommendations if implemented will promote effective communication and enhance monetary policy credibility
- Need for constant review of communication strategies to make them relevant
- Communicating monetary policies in the local languages is long overdue. This should not be left for radio commentators and less informed people
- Central Bank Communication should be done in a less technical language so it is appreciated by all stakeholders
- Central Banks should be proactive in communication policies. Should not be seen to be doing damage control. Eg. Strict enforcement of exchange rate regulations in 2014 and later withdrawal
- Monetary policy credibility depends on how effective it has been over time. Policies should therefore be informed by research and feedback from stakeholders

Thank
you

The text "Thank you" is rendered in a bold, pink, serif font. The word "Thank" is on the top line and "you" is on the bottom line. The letters are decorated with several colorful butterflies in shades of blue, purple, green, and pink, some appearing to be perched on the letters. The background is white.

REFERENCES

- Bernanke, B., Reinhart V. R., and Sack B. P. (2004). “Monetary Policy Alternatives At The Zero Bound: An Empirical Assessment.” *Brookings Papers on Economic Activity*, 2: 1-100
- Faust, Jon, and Lars E.O. Svensson. 2001. “Transparency and Credibility: Monetary Policy with Unobservable Goals.” *International Economic Review*, 42(2): 369-97.
- Fratzscher, Marcel. Forthcoming. “Oral Interventions versus Actual Interventions in FX Markets—An Event-Study Approach,” *The Economic Journal*.
- Gürkaynak, R., B. Sack, and E. Swanson (2005a), “Do Actions Speak Louder than Words? The Response of Asset Prices to Monetary Policy Actions and Statements”, *International Journal of Central Banking*, 1, pp. 55-94.
- Reinhart, Vincent, and Brian Sack 2006. “Grading the Federal Open Market Committee’s Communications.” Unpublished.
- Siklos, Pierre L. 2002. *The Changing Face of Central Banking: Evolutionary Trends Since World War II*, Cambridge University Press.