Monetary Policy Communication
Strategy in the Inflation Targeting Framework
Maria Claudia Gutierrez, Katherine Hennings & Alzira Rosa Morais

Presentation Structure

I. Monetary policy and central banks communication: developments and issues

II. Monetary Policy Communication: the international experience

III. Communication of monetary policy at the Central Bank of Brazil: instruments and content
I – Monetary policy and central banks communication: developments and issues

Monetary Policy and Central Banks Communication

• Transparency, accountability and social legitimacy
• Communication and effectiveness of monetary policy
Monetary Policy and Central Banks
Communication

• Why communicate (Why?)
• What to communicate (What?)
• Limits of Communication (How much?)
• How to communicate (How?)

Monetary Policy and Central Banks
Communication

• Why communicate (Why?)
Why communicate (Why?)

• There has been a change in central banks’ perception on the relevance of their communication;

• The central bank’s mission on the soundness of the financial system and price stability remains the same;

• Monetary policy instruments remain essentially the same, but there was a change in the emphasis in favor of short-term interest rates;

• Monetary policy has become more forward looking and its transmission increasingly takes place through expectations.

Reasons for strengthening communication

• Autonomy of central banks should be accompanied by greater accountability;

• Improving efficiency of monetary policy;

• Reducing the risk of "leaks" of information regarding decisions and actions, so that they are homogeneously disseminated through the market (integrity of the policy-maker).
Monetary Policy and Central Banks
Communication

• What to communicate (What?)

It is almost consensual to disclose:

• the mission of the central bank;
• the target/objective of monetary policy;
• the statistics and scenarios;
• the rationale of the decisions taken by central bank;
• the balance of risks of the evolution of inflation and economic growth;
• the indication of the likely path for monetary policy.
What to Communicate (What?)

Greater discussion on disclosure regarding:
- the projections made by central banks;
- the models used by central banks.

Monetary Policy and Central Banks Communication

- Limits of Communication (How much?)
Limits of Monetary Policy Communication

• Nature of the information and the market pricing;
• Should not constrain future decisions and actions of central banks;
• Credibility x Transparency.

Limits of Monetary Policy Communication

• How to communicate (How?)
How to communicate?

The communication may vary according to:

- The monetary policy regime;
- The organization of the central bank and of the decision-making process.

Practical Aspects of Communication

Announcements made at the IT regime:

• Announcement of decisions;
  • Announcement of the meetings schedule;
  • Communication of decisions;

• Minutes of the meetings;

• Inflation Report;

• Special Reports.

Practical Aspects of Communication

• Other Instruments for Communication
  • Presentations, interviews and other public relations activities;
  • Public Hearings at the Congress;
  • Briefings, workshops and conferences;
  • Other publications;
  • Website content.
II - Monetary policy communication: the international experience

Monetary Policy Transparency: the International Experience

Selected central banks:
- Australia
- Canada
- Chile
- Israel
- New Zealand
- United Kingdom
- Sweden
- ECB
- Federal Reserve System (US)
- Japan
- Switzerland
### Monetary Policy Transparency: the International Experience

#### Decision-making Process

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<thead>
<tr>
<th>Monetary Policy Meetings</th>
<th>Calendar</th>
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Source: Official website of the central banks at the internet.

#### Monetary Policy Transparency: the International Experience

### Monetary policy decision statements

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Source: Official website of the central banks at the internet. N.A. = not available.
Monetary Policy Transparency: the International Experience

### Minutes of Monetary Policy Meetings

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<th>Country</th>
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<th>Lag (in weeks)</th>
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**Source:** Official websites of the central banks. *market analysts, research institutes and universities. N.A. = not available.

### Inflation Targeting

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**Source:** Official websites of the central banks. *market analysts, research institutes and universities. N.A. = not available.
The European Central Bank

The primary objective of the Eurosystem is to maintain price stability (Treaty, art. 105)

• The ECB (Governing Council) is responsible for formulating the monetary policy.
• The ECB seeks low inflation rates, around 2% in the medium-term.

ECB Communication - main formats:
1. Press conferences: immediately after the monetary policy decision
   • Introductory Communiqué - Questions and Answers Session
2. Testimony of the President of the ECB at the European Parliament
3. Speeches of members of the Board

Followed by a questions and answers session
Monetary Policy Transparency: the International Experience

Japan

Press releases, minutes, conferences, monthly reports of economic conditions and projections.

- BoJ announces draft / transcript of the meetings of monetary policy (lag of 10 years) - Established by the BoJ Act.
- Monthly Report - Outlook for Economic Activity and Prices
  I. Outlook for economic activity (quantitative, three years)
  II. Outlook for prices (quantitative, three years)
  III. Balance of risks
  IV. Implementation of monetary policy
- Four-month period Report - Projections of the members of the Monetary Policy Committee and Balance of Risks Graphs - Inflation and activity.

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Monetary Policy Transparency: the International Experience

Japan - Recent Changes July 2008

- Release with reasons will be published with or without change in the interest rate.
- Monthly outlook report will be published on the business day following the meeting of monetary policy as a background document.
- The forecast period was extended in one fiscal year: current year and two years ahead.
- Publication of the balance of risks: instead of yearly, it became quarterly.
- Reduction of the lag for the publication of the minutes of the monetary policy committee meeting
### Federal Reserve System (FED) Communication

#### Federal Reserve System – US

- Until 1994: Explanations of changes in the monetary policy stance were virtually "encrypted";
- Since 1994: Decision to release statement after meetings in which there were policy changes, but to remain silent when there was no change;
- May 1999: Decision to release statement after each FOMC meeting, including the balance of risks associated with the decision;
- In 2002, disclosure of votes on decisions;
- By 2005: Reduction of the lag in the disclosure of FOMC meetings (from 6/7 weeks to 3 weeks)

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#### Federal Reserve System (FED) Communication

#### Federal Reserve System – US

- Minutes of the meetings are available one week before the next meeting.
- Dissemination of quarterly projections presented by each member of the FOMC regarding real GDP growth, unemployment, headline inflation, core inflation and the appropriate monetary policy stance.
- Full transcripts of FOMC meetings are released with a five-year lag.
III - Monetary Policy Communication by the Central Bank of Brazil (BCB): instruments and content

Evolution of Communication by the BCB

Institutional changes and the communication
• Background - until 1996
• Establishment of the Monetary Policy Committee (Copom) – 1996:
  • Increase in the degree of transparency of monetary policy;
  • Enhancement in the regularity and the institutional framework for the monetary policy decision-making process.
• Operational Autonomy
• Accountability of monetary authority
• Inflation Targeting Regime and Fiscal Responsibility Law
The targets for inflation are annual and are set by the National Monetary Council (CMN) 30 months in advance;

The Central Bank is responsible to meet the targets, using the short-term interest rate as instrument;

The Monetary Policy Committee (COPOM) is responsible for the interest rate decision.

Communication is conveyed through:

- Resolution of the CMN announcing the inflation target;
- BCB Communiqué disclosing the meetings schedule;
- Announcement of the decision of the interest rate on the second day of the meeting of the Copom;
- Minutes of the Copom Meeting;
- Quarterly Inflation Reports presented at a press conference by the Deputy Governor for Economic Policy;
- If the target is missed: Open Letter from the BCB Governor to the Minister of Finance.
### Central Bank of Brazil: Monetary Policy Communication

**Statements: Announcements of the Copom decisions**

- **Short texts;**
- **Content:**
  - Explanation of the decision;
  - Indication of the vote (since May 2002);
  - Indication of the monetary policy cycle;
  - Indication of the intensity of monetary policy.
- **Use of key words;**
- **The announcement of the votes.**

### Central Bank of Brazil: Monetary Policy Communication

**Minutes of the Copom meetings**

- **Established by decision of the BCB Board; first release in January 1998;**
- **Lag:** maximum until the Friday after the third meeting following the reference meeting (until 1999); lags up to 15 days (after June 1999); lag of 6 working days (after April 2000);
- **Purpose;**
- **Structured in sections, with the explanation of the decision and strategy in the item "Guidelines for Monetary Policy", afterwards called “Monetary Policy Implementation”.**
Central Bank of Brazil: Monetary Policy Communication

Minutes of Copom meetings (cont.)

• Section with “assessment of inflation trends”;

• Inflation projections (assumptions and scenarios);

• Extension of the interpretation of the scenario;

• Presentation of the assessment of the scenario in terms of maintenance of inflation consistent with the trajectory of the established targets;

• Explanation of the monetary policy strategy;

• Use of educational messages.

Yield Curve – April 2002 Meeting

4/17/02 – Copom meeting
4/18/02 – Adjustment to the decision
4/24/02 – Eve of the Copom Minutes release
4/25/02 – Release of Copom Minutes
Yield Curve – September 2004 Meeting

9/15/04 – Copom meeting
9/16/04 – Adjustment to the decision
9/22/04 – Eve of the Copom Minutes release
9/23/04 – Release of Copom Minutes

Yield Curve – January 2005 Meeting

1/19/05 – Copom meeting
1/20/05 – Adjustment to the decision
1/26/05 – Eve of the Copom Minutes release
1/27/05 – Release of Copom Minutes
Yield Curve – July 2008 Meeting

Central Bank of Brazil: Monetary Policy Communication

Inflation Report

- Preparation and disclosure established by Decree 3088/99;
- The broadest and the most complete communication channel;
- Structured in 6 chapters:
  - Activity level – Prices - Credit, Monetary and Fiscal Policies –International Economy –External Sector;
  - Inflation Outlook.
- Displays the recent scenario, the interpretation of inflation drivers, the main prospective scenario, with assumptions and risks and the inflation prospects;
- Projections for inflation and GDP and the baseline scenarios;
- Boxes.
Inflation Report

- Projections:
  - Assumptions and scenarios;
  - Variables;
  - Forecast period;

- Boxes:
  - Methodology;
  - Monetary policy;
  - Projections;
  - Specific aspects of the economic outlook;
  - Economy behavior.

Inflation Report (IR)

- Disclosure - BCB website and by printed version;
- Presentation and press conference by the Deputy Governor for Economic Policy (since 2001) also available at the BCB website;
- Presentation of the Inflation Report at the regional offices of the BCB (since September 2007);
- Broadcast of the presentation and interview placed at the BCB website, in real time and available on line afterwards (since September 2008).
Documents also disclosed:

- Weekly: Statistical bulletin of economic indicators (internet);
- Weekly: Focus Report on the median and the average market expectations for inflation, output, exchange rates and other macroeconomic variables;

• Time Series (statistics);
• Annual Report (analysis);
• Technical Notes Series of the BCB (research);
• Series of Working Papers of the BCB (research);
• Financial Stability Report (biannual review);
• Report on Banking and Credit (annual review).
Central Bank of Brazil: Monetary Policy Communication

Measuring the degree of transparency

• Transparency Index

Measuring the effectiveness of monetary policy communication

• Effect on the yield curve
  • Variance of asset prices

• Effect on the curve
  • Change in level
  • Effect on expectations

How to Measure the Transparency of Central Banks in Monetary Policy?

Dimensions of transparency in monetary policy

Transparency and Index - Eijffinger and Geraats (2003)

I. Policy and Targets
II. Economic information disclosed
III. Procedures
IV. Decisions
V. Operational
Measuring the level of transparency

- Transparency Index

Eijffinger and Geraats (2002)

Eijffinger and Geraats Transparency Index
(minimum=0, maximum=3)

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- The Central Bank of Brazil presents a degree of transparency higher than the required by the statutory rules governing its actions;

- Communications used as strategic instrument for the coordination of expectations.
Measuring The Predictability of Monetary Policy (BCB)

Surprise of the monetary policy decision:

- Difference between the Selic Interest Rate announced by the Copom (month t) and Market Expectations one month prior to the Copom decision (t-1);
- Deviation between Selic Interest Rate announced by the Copom (month t) and Market Expectations three months prior to the Copom decision (t-3).
Surprise of the Monetary Policy Decision
3-Month Lag (t-1)

Surprise of the Monetary Policy Decision
3-Month Lag (t-3)
Measuring the Predictability of Monetary Policy

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red: tightening; blue: easing

Summarizing

- In the inflation targeting regime, the communication has strong relevance in the coordination of expectations, contributing to the greater effectiveness of monetary policy;
- However, the focus of the transparency and communication of central banks should be to contribute to the institutional mission, and should not constitute an objective itself;
- In the debate between full transparency and communication limits, the focus should be on marginal benefits versus incremental costs of information.
Thank you!