



XI Seminário Anual de Metas para a Inflação

Monetary Policy Communication Strategy in the Inflation Targeting Framework

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BANCO CENTRAL DO BRASIL

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

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Monetary Policy and Central Banks Communication



- **Transparency, accountability and social legitimacy**
- **Communication and effectiveness of monetary policy**

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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.

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Why communicate (Why?)



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).

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Monetary Policy and Central Banks Communication



- **What to communicate (What?)**

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.

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Monetary Policy and Central Banks Communication



- Limits of Communication (How much?)

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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.**

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Limits of Monetary Policy Communication



- **How to communicate (How?)**

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How to communicate?



The communication may vary according to:

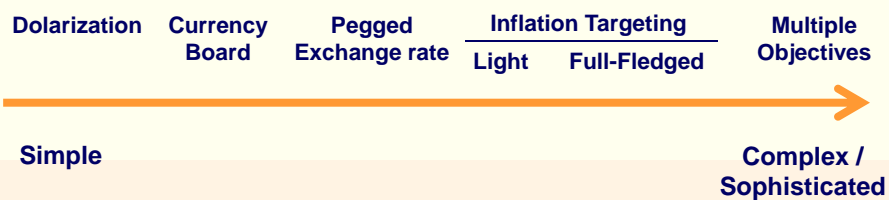
- The monetary policy regime;
- The organization of the central bank and of the decision-making process.

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Complexity Scale of Central Bank Communication



- Blinder, et al (2002): Complexity scale of central bank communication in different monetary regimes



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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.

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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.

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II - Monetary policy communication: the international experience

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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**

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Monetary Policy Transparency: the International Experience



Decision-making Process

		Monetary Policy Meetings		
		Calendar	Quant.	Decision
Inflation targeting	Australia	Rule	11	Committee
	Brazil	Yes	8	Committee
	Canada	Yes	8	Committee
	Chile	Yes	12	Committee
	Israel	Yes	11	Governor
	N. Zealand	Yes	8	Governor
	United Kingdom	Yes	12	Committee
	Sweden	Yes	6	Committee
Special	Japan	Yes	12-24	Committee
	Switzerland	No	6	Committee
	ECB	Yes	12	Committee
	US	Yes	8	Committee

Source: Official website of the central banks at the internet.

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Monetary Policy Transparency: the International Experience



Monetary policy decision statements

		Release	Lengh	Vote	Scenario	Balance of Risks	Prospects
Inflation Targeting	Australia	Yes	Medium	No	Yes	No	No
	Brazil	Yes	Short	No	No	No	No
	Canada	Yes	Medium	Consensus	Yes	Yes	Yes
	Chile	Yes	Medium	Yes	Yes	Yes	Yes
	Israel	Yes	Long	N.A.	Yes	Yes	No
	N. Zealand	Yes	Medium	N.A.	Yes	Yes	Yes
	U. Kingdom	Yes	Medium	No	No	Yes	No
	Sweden	Yes	Long	No	Yes	Yes	Yes
Special	Japan	Yes	Medium	Yes	No	No	No
	Switzerland	Yes	M/L	No	Yes	Yes	Yes
	ECB	Yes	Long	No	Yes	Yes	Yes
	US	Yes	Medium	No	Yes	Yes	Yes

Source: Official website of the central banks at the internet. N.A. = not available.

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Monetary Policy Transparency: the International Experience



Minutes of Monetary Policy Meetings

		Release	Lag (in weeks)	Vote	Balance of risks	CB Projections	Others*
Inflation Targeting	Australia	Yes	2	No	Yes	No	No
	Brazil	Yes	1	Yes	Yes	No	Yes
	Canada	No	-	-	-	-	-
	Chile	Yes	2	Yes	Yes	No	Yes
	Israel	Yes	2	N.A.	Yes	Yes	Yes
	N. Zealand	No	-	-	-	-	-
	U. Kingdom	Yes	2	Yes	Yes	Yes	Yes
	Sweden	Yes	2	Yes	Yes	Yes	Yes
Special	Japan	Yes	4	Yes	Yes	-	-
	Switzerland	No	-	-	-	-	-
	ECB	No	-	-	-	-	-
	US	Yes	3	Yes	Yes	No	No

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

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Monetary Policy Transparency: the International Experience



Inflation Report

		Release	Frequency	CB Projections	Models of Disclosure
Inflation Targeting	Australia	Yes	Quarterly	Yes	No
	Brazil	Yes	Quarterly	Yes	No
	Canada	Yes	Quarterly	Yes	No
	Chile	Yes	4-month period	Yes	No
	Israel	Yes	Quarterly	Yes	No
	N. Zealand	Yes	Quarterly	Yes	No
	U. Kingdom	Yes	Quarterly	Yes	No
	Sweden	Yes	4-month period	Yes	No
Special	Japan	Yes	Monthly*	Yes	No
	Switzerland	Yes	Quarterly**	Yes	No
	ECB	No	-	-	No
	US	Yes	-	-	No

Source: Official websites of the central banks

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Monetary Policy Transparency: the International Experience



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

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Monetary Policy Transparency: the International Experience



The European Central Bank

Monthly press conference

- introductory paragraphs;
- economic analysis;
- monetary analysis;
- final paragraph checking the economic and monetary results;
- addendum.

Followed by a questions and answers session

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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

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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.

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III - Monetary Policy Communication by the Central Bank of Brazil (BCB): instruments and content

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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**
 - Adoption of inflation targeting (1999) – Dec. 3088/99
- **Accountability of monetary authority**
- **Inflation Targeting Regime and Fiscal Responsibility Law**

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Central Bank of Brazil: Monetary Policy Communication



- 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.

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Central Bank of Brazil: Monetary Policy Communication



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.

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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.**

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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".

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Central Bank of Brazil: Monetary Policy Communication

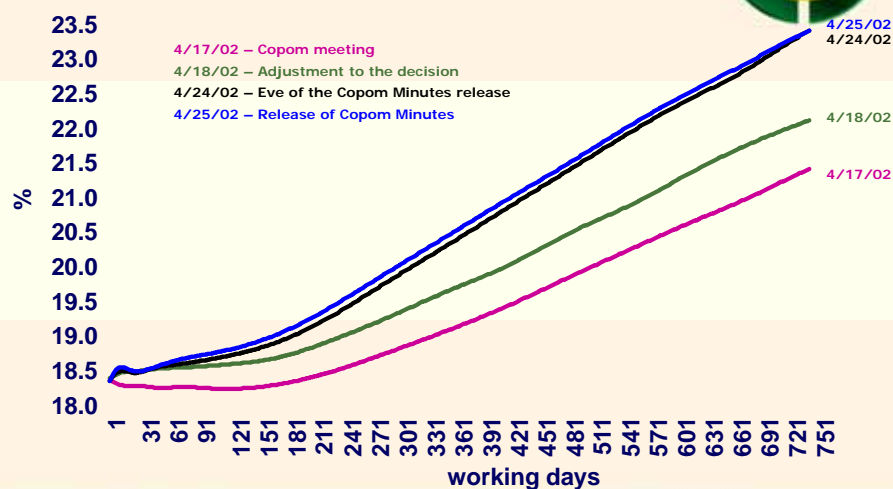


Minutes of Copom meetings (cont.)

- 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.

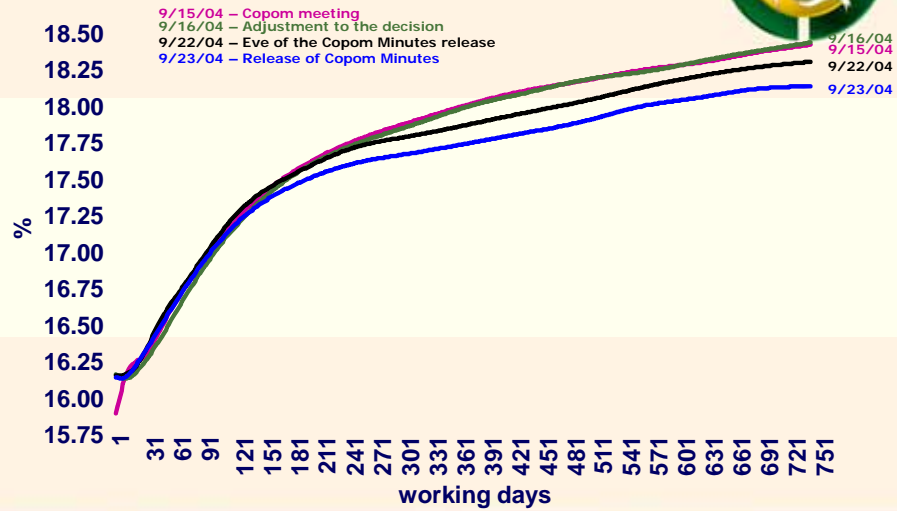
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Yield Curve – April 2002 Meeting



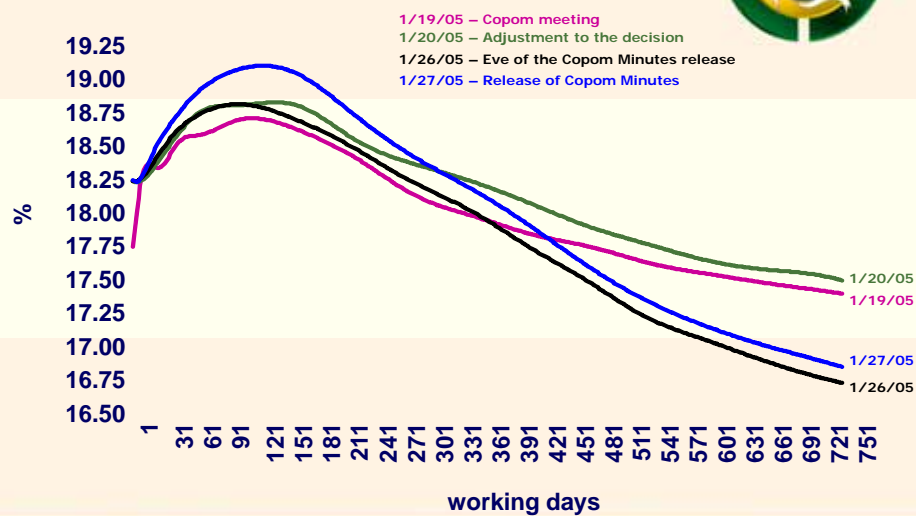
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Yield Curve – September 2004 Meeting



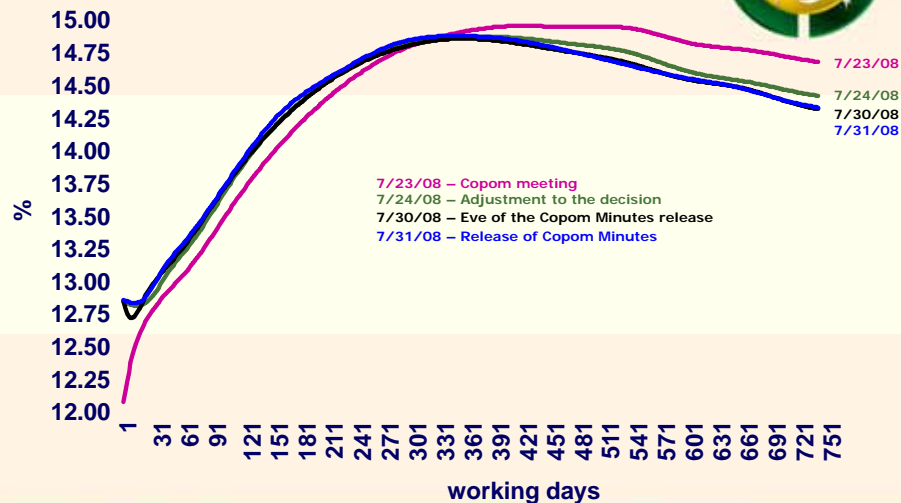
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Yield Curve – January 2005 Meeting



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Yield Curve – July 2008 Meeting



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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.

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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).

Central Bank of Brazil: Monetary Policy Communication



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;
- **Monthly:** Economic-Financial Press Releases with press conference (External Sector, Monetary Policy and Credit Operations, Fiscal Policy and Open Market) .

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Central Bank of Brazil: Monetary Policy Communication



- **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).**

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Central Bank of Brazil: Monetary Policy Communication



Measuring the degree of transparency

- Transparency Index

Eijffinger and Geraats (2002, 2005)

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

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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

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Central Bank of Brazil: Monetary Policy Communication



Measuring the level of transparency

- Transparency Index

Eijffinger and Geraats (2002)

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

	2.5	3	0.5	10.5
			2	12
			2.5	12.5

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Central Bank of Brazil: Monetary Policy Communication



- 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.

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Measuring The Predictability of Monetary Policy (BCB)

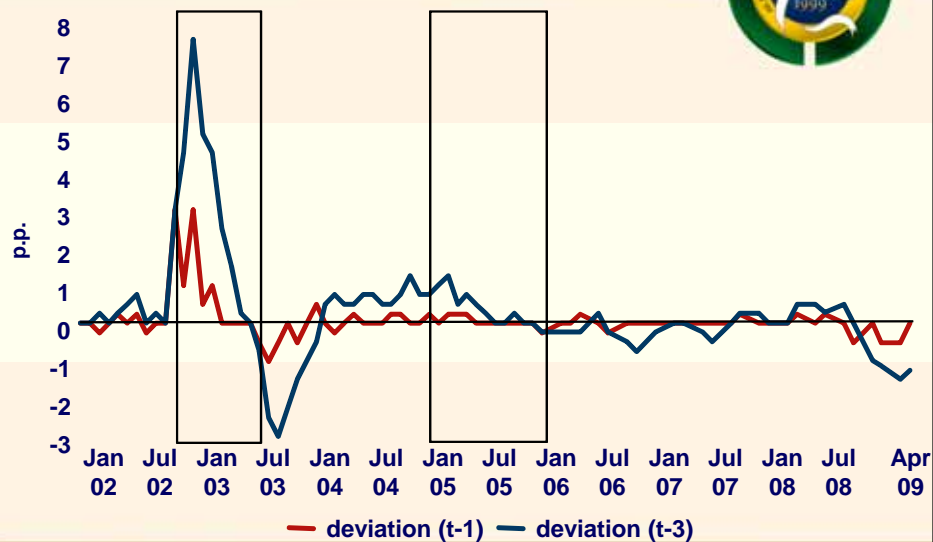


Surprise of the monetary policy decision:

- 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 ($t-3$).

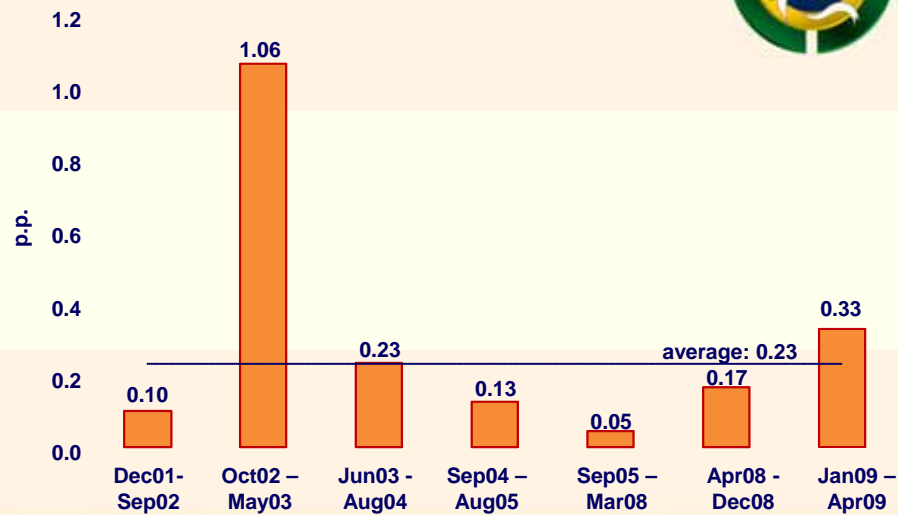
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Measuring The Predictability of Monetary Policy (BCB)



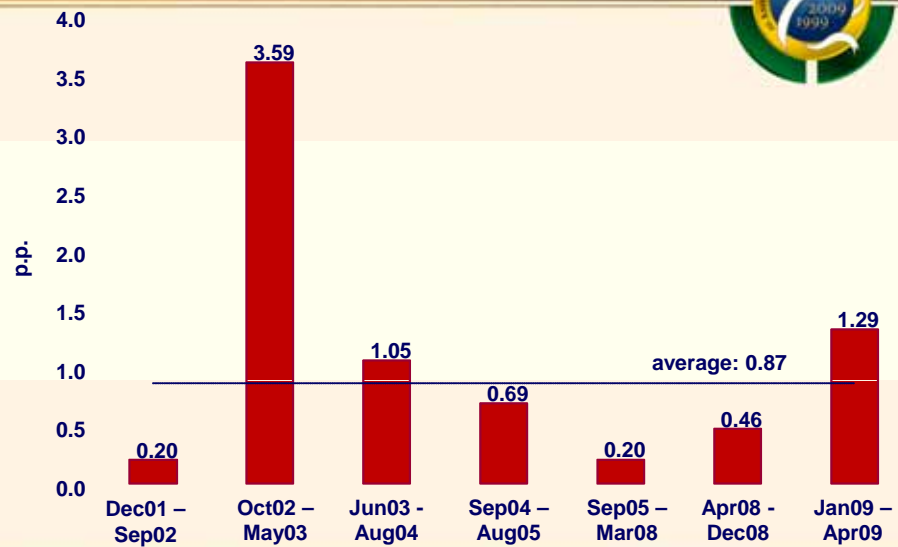
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Surprise of the Monetary Policy Decision 3-Month Lag (t-1)



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



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Measuring the Predictability of Monetary Policy



	Average Deviation (p.p.)			Standard Deviation (p.p.)	
	(t-1)	(t-3)		(t-1)	(t-3)
Dec01-Sep02	0.10	0.20	Dec01-Sep02	0.13	0.26
Oct02-May03	1.06	3.59	Oct02-May03	1.27	2.27
Jun03-Aug04	0.23	1.05	Jun03-Aug04	0.31	0.87
Sep04-Aug05	0.13	0.69	Sep04-Aug05	0.13	0.37
Sep05-Mar08	0.05	0.20	Sep05-Mar08	0.10	0.20
Apr08-Dec08	0.17	0.46	Apr08-Dec08	0.20	0.33
Jan09-Apr09	0.33	1.29	Jan09-Apr09	0.29	0.19
Dec01-Apr09	0.23	0.87	Dec01-Apr09	0.52	1.30

red: tightening; blue: easing

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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.

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Thank you!



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