

Communication in Monetary Policy: Experiences of the Swiss National Bank

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Structure of presentation

1. Introduction
2. Results of the literature
3. Consensus view of central bankers
4. SNB's monetary policy concept
5. SNB's communication experiences
6. Challenges
7. Conclusions

1. Introduction

- ◆ Remarkable change in central banks' attitude over time:
Transparency now deemed beneficial instead of detrimental
- ◆ Significant increase of transparency at central banks
- ◆ Increased importance of communication in monetary policy strategies

2. Results of the literature

- ◆ Burgeoning literature
- ◆ No unique concept of transparency
- ◆ In general: transparency relevant if asymmetric information
 - Provision of knowledge about all aspects of the monetary policy strategy
 - Disclosure of all information relevant for understanding monetary policy decisions

Theoretical results

- ◆ Positive impact of transparency: Increase in reputation, elimination of inflation bias, reduction of market uncertainty
- ◆ Negative impact of transparency: Potentially harmful for macroeconomic stability
- ◆ Transparency more important for central banks with poor credibility than for those with high credibility
- ➔ No straightforward guidance from theory for designing transparency and communication policy in practice

Mainly favorable empirical evidence

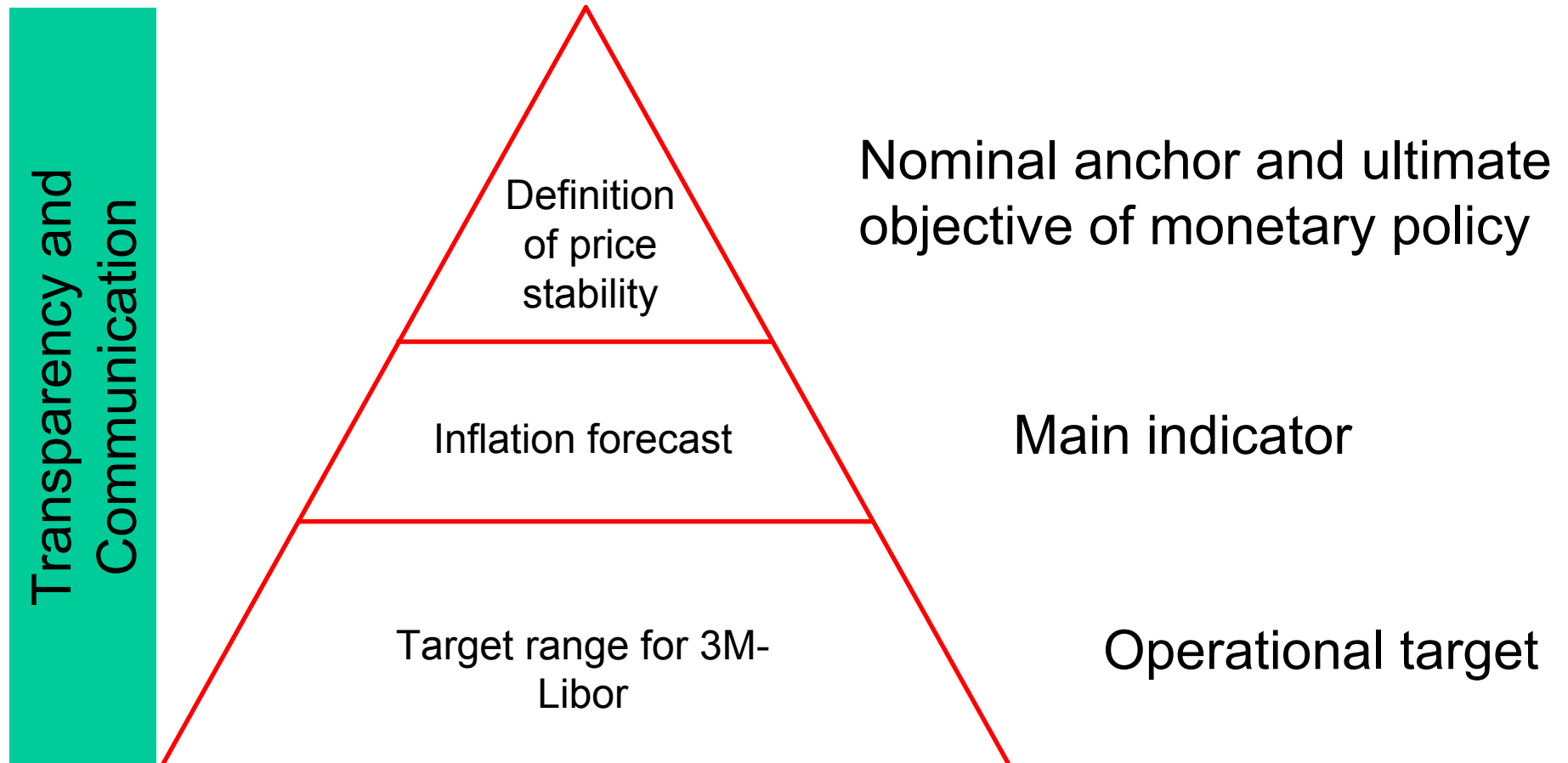
Higher transparency leads to:

- ◆ Reduction of inflation and sacrifice ratios
- ◆ Diminishing sensitivity of inflation expectations to past inflation
- ◆ Enhanced flexibility for reactions to shocks
- ◆ Increased predictability of monetary policy

3. Consensus view of central bankers

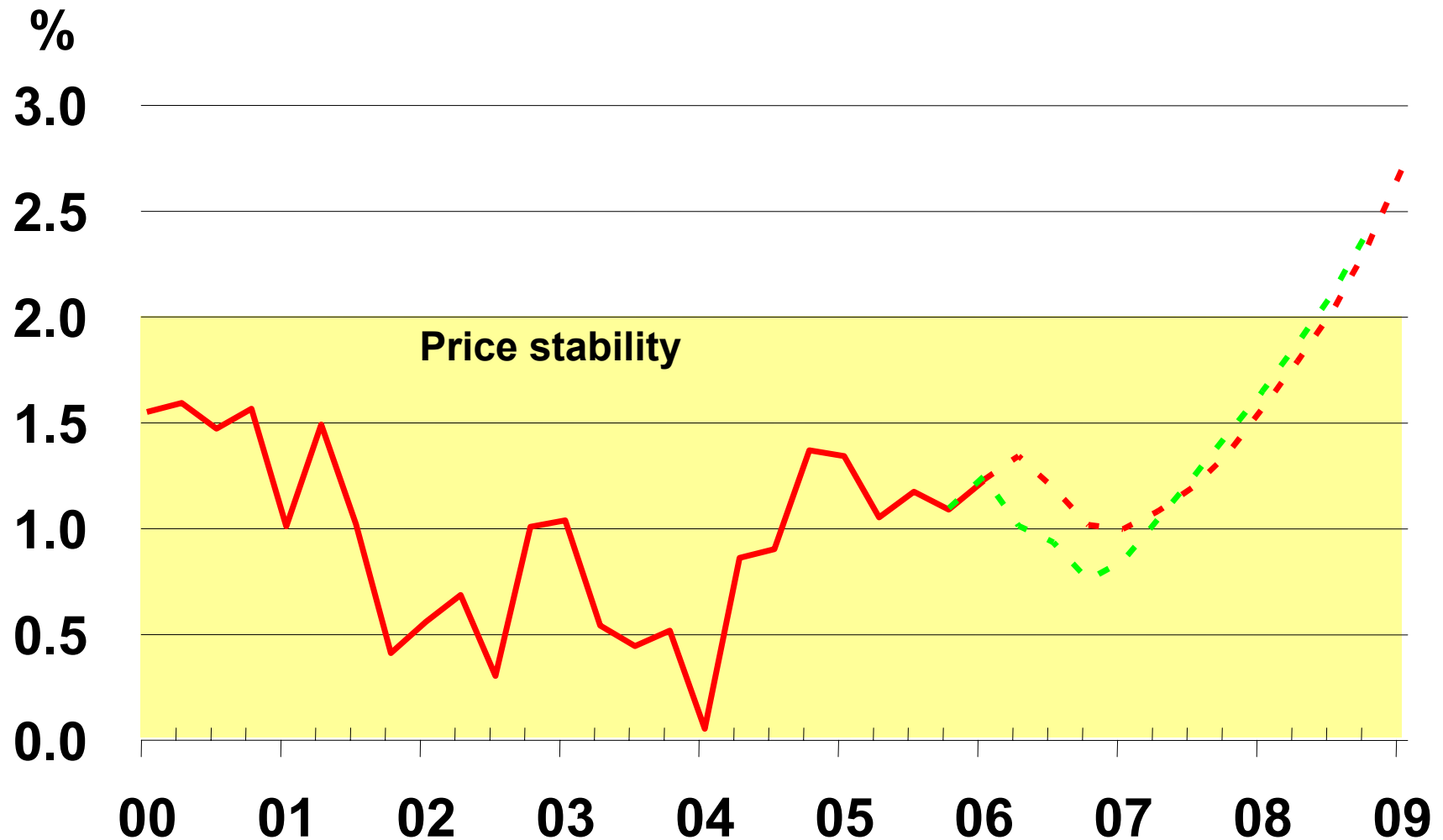
- ◆ Transparency
 - Counterbalance to institutional independence and delegation of authority
 - Necessity for monetary policy effectiveness
- ◆ Effective communication
 - Means of increasing transparency, accountability and credibility
 - Support of policy intentions
- ◆ Optimal transparency and communication set-up may differ from country to country

4. SNB's monetary policy concept

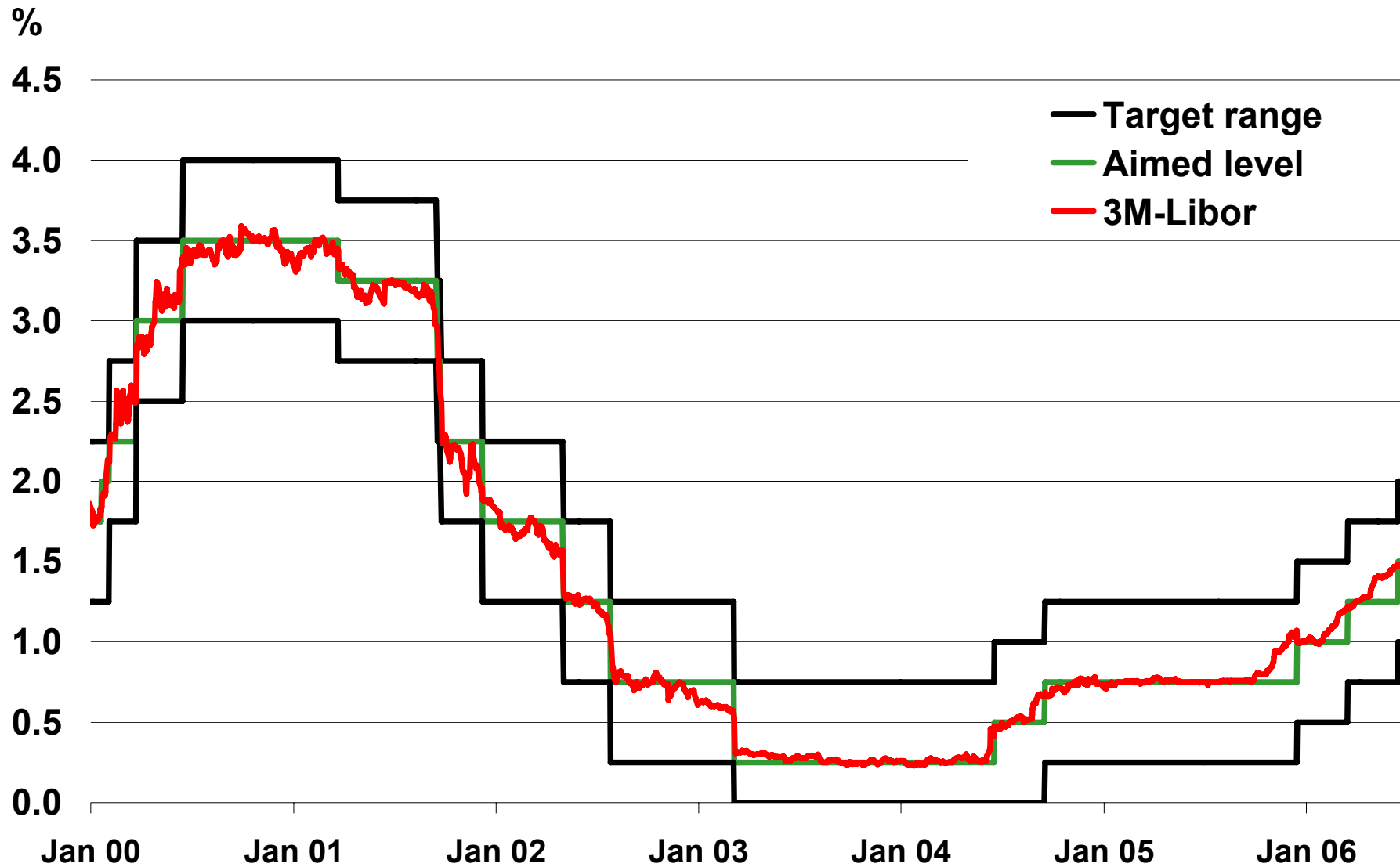


Inflation Forecast June 2006

Assumption: steady three-month Libor of 1.50% (June) vs. 1.25% (March)



Target Range and 3M-Libor



Some remarks about the concept

- ◆ Definition of price stability as nominal anchor for monetary policy; but no inflation target
- ◆ Inflation forecast as main indicator but not as intermediate target
- ◆ Operational target: some flexibility to dampen shocks
- ◆ Broadly based set of information (suite of forecasting models, monetary aggregates, ...)
- ◆ Quarterly meetings to review monetary policy; unscheduled meeting possible if immediate decision necessary

Elements of SNB communication

- ◆ Description of monetary policy concept
- ◆ Description of set of relevant information variables and forecasting models
- ◆ Announcement of scheduled policy meetings
- ◆ Communiqué and press conference after policy decisions with publication of inflation forecast and target range for 3M-Libor
- ◆ Quarterly Monetary Policy Report
- ◆ Speeches and interviews
- ◆ Annual Accountability Report

5. SNB's communication experiences

- ◆ Communication and transparency central elements of SNB monetary policy since the end of the Bretton Woods system
- ◆ Significant step forward with new monetary policy concept
- ◆ Conviction: Effective communication not only important for accountability but a prerequisite for monetary policy efficiency
- ➔ However, transparency not for the sake of transparency
- ➔ Continuous and careful refinement of communication policy and strategy

Communication of policy concept

- ◆ Detailed description of the monetary policy concept
- ◆ Announcement of scheduled policy meetings
- ◆ Publication of forecasting models
- ◆ Indication of set of relevant information variables (exchange rates, money aggregates, ...)
- ➔ Allowing markets to draw similar conclusions from incoming data

Communication of policy decisions

- ◆ Publication of target range for 3M-Libor
- ◆ Additional indication: 3M-Libor aimed to remain in upper, middle or lower part of target range
- ◆ Elaborated communiqué and press conference after meeting
- ◆ Publication of inflation forecast (no fan-chart; constant interest rate hypothesis)
- ◆ Detailed quarterly Monetary Policy Report
- ◆ No publication of minutes or transcripts of policy meeting

Transparency for money market

Weekly publication of relevant data for money market participants:

- ◆ Assets and liabilities of the SNB
- ◆ Compliance of banking sector with minimum reserves
- ◆ Results of monetary policy transactions (terms, bids and allotments)

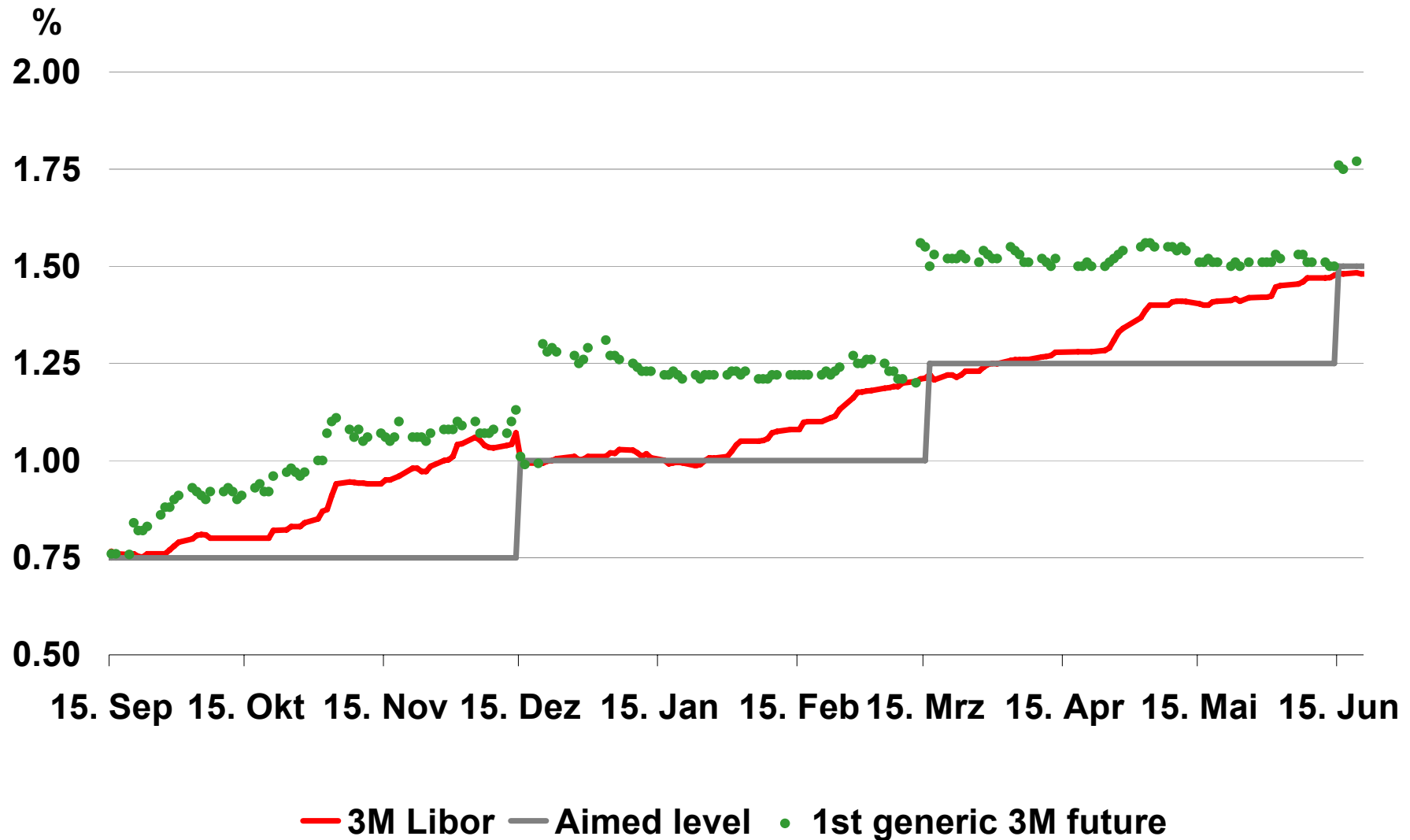
Management of expectations

SNB manages expectations by providing:

- ◆ Interpretation of published inflation forecast
- ◆ Information about likely future policy course
- ◆ Conditions for further policy adjustments
- ◆ Escape clauses (e.g. exchange rate development)

- ◆ But no publication of future path of 3M-Libor and no mechanical reaction to inflation forecast
- ◆ Example: Normalization of monetary policy by gradual tightening (December 2005 - ...)

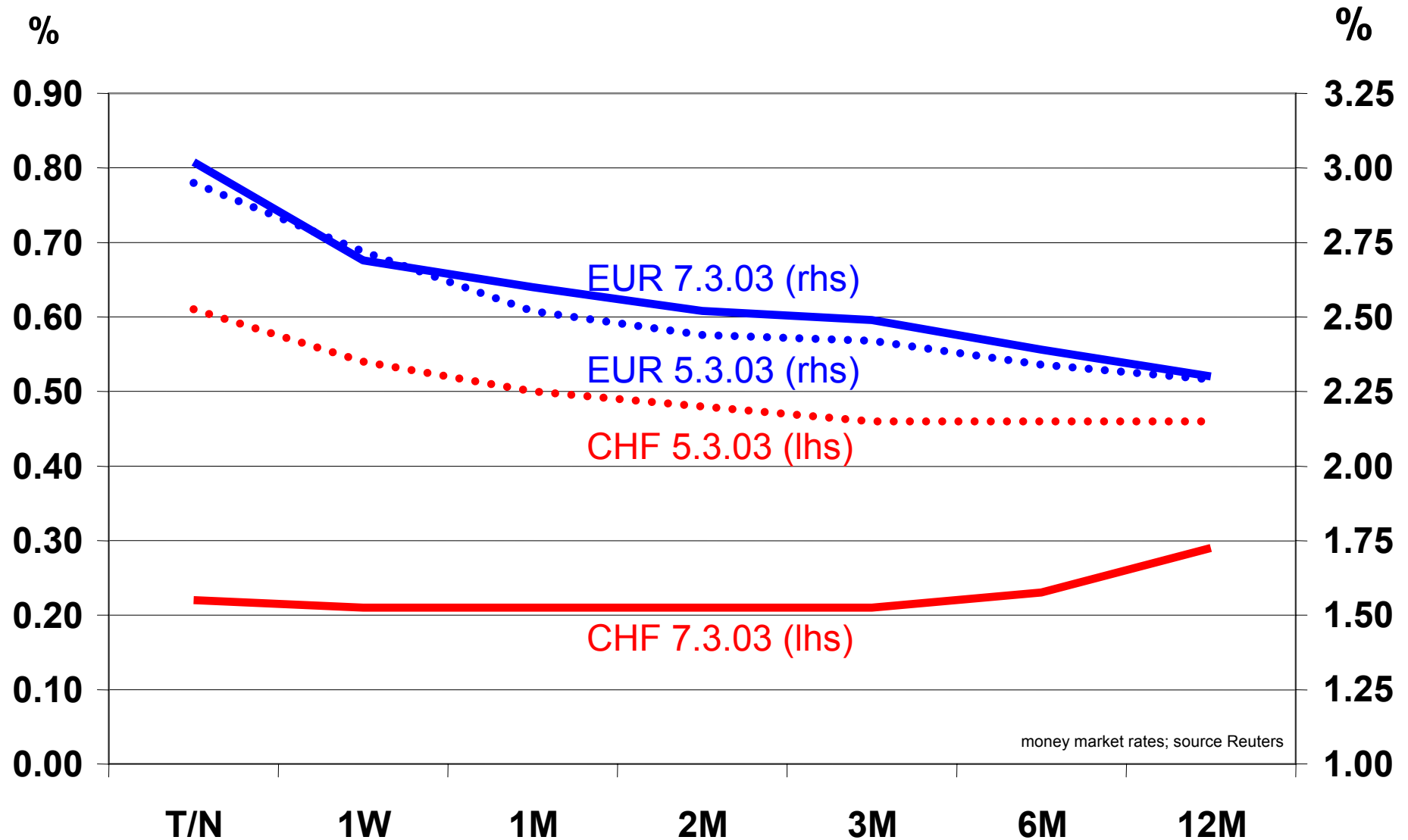
Gradual tightening 2005-2006



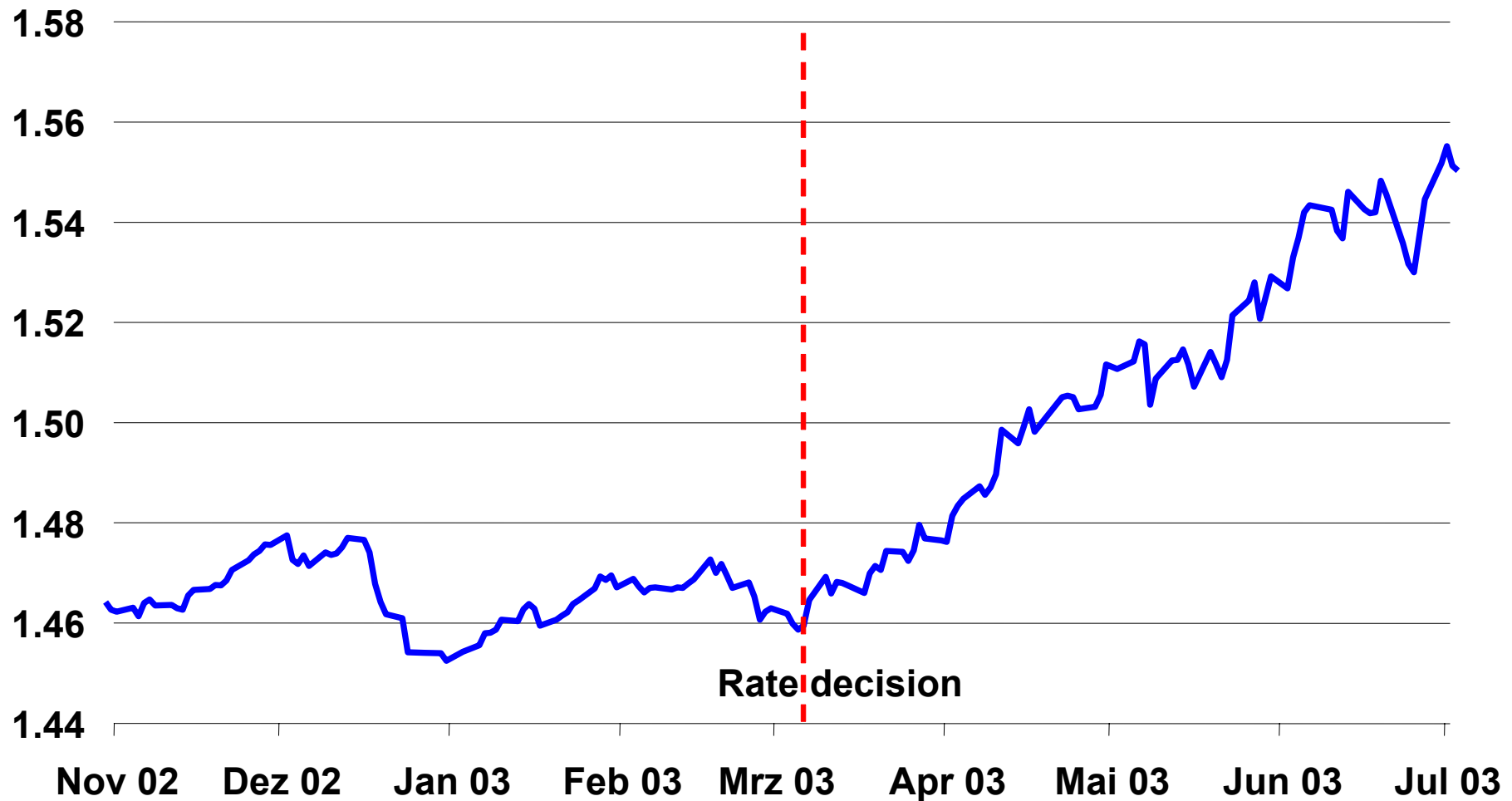
Policy surprises:

- ◆ Increased consistency in views due to effective communication
- ◆ However, on occasion diverging views
 - ➔ Policy surprises indispensable...
 - ➔ ... and often unavoidable and not harmful for credibility of central banks if understandable
- ◆ Examples:
 - March 2000: 75 bp interest rate hike
 - March 2003: begin of near-zero interest rate policy

Surprise March 2003: Term structure



Surprise March 2003: EUR/CHF



Avoiding confusion

- ◆ Only few people involved in communication
- ◆ Concentration on relevant information
- ◆ Discipline of policy makers: homogeneous view of Board members
- ◆ Official press release as base document for contact with public and markets

Successful communication of SNB

- ◆ Positive response from public and markets
- ◆ Successful steering of interest rate expectations
- ◆ Successful monetary policy: price stability and firm inflation expectations for more than a decade
- ◆ No confusions in markets about SNB's intentions
- ◆ To a large extent congruent analysis of SNB and markets
- ◆ No evidence of missing elements in communication

6. Challenges

- ◆ Nature of published inflation forecast: Evaluation of different possibilities
- ◆ Policymakers' loss function: Is high specification possible and desirable?
- ◆ Right amount of information: Trade-off between openness and clarity

Publication of inflation forecasts I

Conditioned on fixed interest rates (unchanged policy):

◆ Advantages:

- Simplicity; clear interpretation
- No agreement on future path for interest rates necessary

◆ Disadvantages:

- Potential model-specific inconsistencies
- Inflation forecast not comparable with forecasts from forecasting institutes

Publication of inflation forecasts II

Conditioned on policymakers' intended interest rate path:

- ◆ Advantages
 - Realistic assumption
 - Prediction of future interest rates
- ◆ Disadvantages:
 - Misunderstanding with repercussions on central bank credibility if interest rate path regarded as commitment
 - Complicated agreement among policymakers about future interest rates

Publication of inflation forecasts III

Based on current market expectations of short-term rates

◆ Advantages:

- No agreement among policymakers for optimal path of future interest rates necessary
- Derived from public information

◆ Disadvantages:

- Limited forecastability of the market
- Unclear interpretation of inflation forecasts
- Computation of market expectations not straightforward

Specification of SNB's loss function

- ◆ SNB mandate: Ensuring price stability by taking development of the economy into account
- ◆ Definition of price stability; but no specification of output stabilization objective
- ◆ Difficulties with explicit loss function:
 - Primary vs. secondary objective
 - Level vs. volatility objective
 - Aggregating policymakers' preferences
 - Interpretation for the public

Correct amount of information

Risk of confusion due to surplus of information:

- ◆ Limited digestibility of information
 - ◆ Trade-off between openness and clarity
 - ◆ Unintended market reactions
- ➔ Finding ideal balance between quantity and quality of information

7. Conclusions

- ◆ No communication panacea available
- ◆ Communication policy country-specific and dependent on monetary policy concept as well as on central bank's history
- ◆ SNB's communication fairly successful so far
- ◆ Communication and transparency steadily changing
- ◆ Trendy concepts not risk-free