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# Central Bank Communication and the Financial Markets

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# Evolving academic attitudes

- Karl Brunner (1981): Central bankers refuse to speak in “intelligible words and sentences.”
- Alan Blinder (1996): By guiding expectations, greater openness enhances the effectiveness of monetary policy.
- Michael Woodford (2001): The view that monetary policy is about managing expectations is “widespread.”

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# A practical success story

- This is progress!
- It's a case where academic thinking influenced actual CB practice, *mostly before there was any empirical evidence.*
- ✓ But there now is.
- Norway and Sweden may now be the transparency leaders.

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# An important reminder

- The case for openness rests on *two* co-equal foundations:
  1. democratic accountability
  2. monetary policy effectiveness
- I will deal with #2, but #1 is just as important.

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# Prefatory Note 1

- CB communications would be superfluous under *rational* expectations in a *stationary* environment with a central bank *credibly committed* to an *unchanging* policy rule.
- Implication: CB communications contribute by *improving understanding* of *evolving* policy “rules” in a *non-stationary* environment with *asymmetric* information and *learning*.

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# Prefatory Note 2

- Can there be too much CB communication?
- Well, I'm skeptical, but...
  - ✓ Confidentiality and “purdah”
  - ✓ If it's only unanticipated policy that matters (Cukierman & Meltzer)
  - ✓ If CB signals crowd out other valuable information (Morris & Shin)
  - ✓ the cacophony problem
- Only the last seems important in practice.
  - ✓ It argues for clarity, not silence.

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## Prefatory Note 3

- Communication need not imply commitment--  
*unless the CB wants it to.*
- ✓ This is a common confusion.
- This point is critical in thinking about publishing interest rate forecasts and other forms of “forward guidance.”

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# Some key empirical questions

(survey paper by Blinder, Ehrmann, Fratzscher, De Haan, and

Jansen)

- *Short term*: Do CB communications (a) make policy more predictable, (b) move financial market prices?
  - ✓ Strongly? In the right direction?
  
- *Long term*: Do CB communications (e.g., a numerical inflation target) anchor expectations and/or reduce inflation?



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# CB communications and financial market prices: creating news and reducing noise

- Predicting the next monetary policy decision
  - ✓ Markets have gotten better at it as communication has increased. The evidence is plentiful and one-sided.
  - ✓ There is a little evidence that “cacophony” (dispersed communication) hurts.
- Impacts on interest rates *et al.*
  - ✓ Re: which types of communications matter most, there is no clear “winner.”
  - ✓ There is some suggestive evidence that greater clarity helps. (next slide)

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# Clarity and CB communication

1. Fracasso, Genberg, Wyplosz (2003): *higher quality* inflation reports → smaller policy surprises
2. Ehrmann and Fratzscher (2007): ECB *press conferences* → more impact on asset prices and less on volatility (than statements)
3. Jansen (2008): more *readable* testimonies → less volatility.

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# Anchoring expectations and inflation

- Re: anchoring expectations
  - ✓ It's a prime argument for IT.
  - ✓ The evidence here seems one-sided: They do.
- Re: reducing average inflation
  - ✓ Here the evidence is far from clear.
  - ✓ One reason: There is a two-way causation problem.
  - ✓ Another reason: Compared to whom? (Mishkin and Schmidt-Hebbel)

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# The new frontier: projecting the path of the policy rate (1)

- *For researchers:* How tightly, strongly, and accurately does it condition market expectations (e.g., in NZ, Norway, Sweden)?
  - ✓ Three recent papers suggest that it does not crowd out all other ideas.
- *For researchers:* Do markets understand the conditionality of the projections (in NZ)?
  - ✓ The same papers suggest that they do.

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# The new frontier: projecting the path of the policy rate (2)

- *For practitioners:* balancing the pros and cons (and feasibility)
  - ✓ Operational feasibility is a serious issue at many CBs.
  - ✓ But let's remember, the “unthinkable” has become “thinkable” many times before.

# “Best practice”

- Almost all CBs should communicate more.
  - ✓ And more clearly!
- Post a numerical inflation target ( $\neq$  IT)
  - ✓ Some ITers are less than transparent.
- Statements, minutes, etc. must to tailored to the MPC's nature and structure.
- Forecasts should be released contemporaneously.
  - ✓ Whose forecasts?
  - ✓ Does forecast include the future policy rate?
- Collegial committees need “one voice.”  
Individualistic committees need many voices.
- Publish interest rate projections? An open issue