

Speech

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Openness and clarity in monetary policy – Swedish experiences

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Let me begin by thanking you for the invitation to come here and speak about openness and clarity in monetary policy. This has been a topical subject in the Swedish debate recently, among other things against the background of the new Executive Board of the Riksbank. It is also very much discussed internationally, not least in the debate concerning the new European Central Bank, the ECB.

There are many issues to shed light on as regards transparency and clarity in monetary policy. Today, I intend to concentrate mainly on some of the issues connected with the changes at the Riksbank during the past year. Before doing so, however, I shall say something about the basic arguments for transparency and briefly describe how I perceive that monetary policy developed in some of these respects before the new Executive Board took office.

1. Transparency and the possibility of establishing accountability

The importance of "transparency and accountability" is often discussed in the international debate. Transparency entails openness and clarity. Accountability is about the ability to impose responsibility, more specifically that it shall be possible to identify those responsible for policy and policy objectives. In practice, it assumes transparency about the process leading to decisions.

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Are then transparency and the possibility of exacting responsibility important prerequisites for a well-functioning monetary policy? Most people would probably answer yes, although when the question is defined more exactly, there is no longer the same unanimity in either the Swedish or the international debate. The differing views probably depend a lot on different national traditions with regard to openness in society as a whole, although views can also differ between countries, as between individuals, about how to achieve accountability and maintain democratic control. It is also about the approach to financial markets and how well different ways of conducting monetary policy have been seen to work previously in different environments.

Let me draw attention to some of the arguments for transparency that are common in the economic debate and also comment on something that has guided my work at the Riksbank. Perhaps I can underline that there are strong links between the different arguments.

Credibility

The main argument for transparency and clarity is usually that it can contribute to establishing the credibility of monetary policy. In the academic literature, the focus has been mainly on it being easier for professional analysts in the financial markets to continuously monitor, understand and evaluate central bank activities. These analysts can thereby also assure themselves that the considerations that are taken are not unwarranted and that policy is carried out in what is usually referred to as a time-consistent way. This argument is particularly important for a central bank which, like the Riksbank in the 1990s, has built up confidence in a new regime. By communicating clearly and openly, a central bank can find a short cut to the credibility that otherwise requires a long record of good results.

Legitimacy

One aspect that is seldom highlighted in the economic discussion but which in my view is crucial is that it is hardly possible in the long run to conduct monetary policy in a way that is credible in the normal sense of the word if broad support for policy is lacking. Successful monetary policy requires understanding and support in society at large. Also in this respect, the results of policy and its professional implementation are naturally of key importance. Formulating clear objectives and procedures, in order to commit oneself and facilitate evaluation and questions, can be a way of creating understanding, support and respect. The requirement of accountability seems particularly reasonable for institutions that have a lot of power, which is the case today for central banks in Europe. In addition, citizens in a democracy should be able to demand transparency in monetary policy in the same way as from all other policy, something that Alan Blinder, a former deputy head of the Federal Reserve, has pointed out.

Predictability

There are good reasons to believe that a more transparent interest rate policy functions better in a technical sense. If different participants in the economy – in financial markets, in business and households – can more easily foresee the future direction of monetary policy and adjust to it, it should be possible to reduce the fluctuations in interest rates and other market prices. This should lead to a more

stable development in the real economy. My British colleague, Mervyn King, has formulated this idea as being to make policy so predictable that it becomes boring. In his view, there is no point whatsoever in surprising the markets. My impression is that this view has gained increased support in the central bank sphere in recent years but is by no means fully accepted everywhere.

Efficiency in the organisation

To conclude, I would like to underline that transparency and the ability to demand responsibility are important for the organisation's internal life and efficiency. This is not least the case in institutions which, like central banks, have a monopoly and moreover have had a tradition of secrecy. Clear objectives and the ambition both to publish the basis for decisions and motivate the public in a convincing way increase the focus of work and make the analysis more stringent. They also promote a broader monetary policy discussion in the community, which in turn can be fed back into the central bank in a constructive way. Working at a central bank may be less comfortable but I believe the results will be good.

2. The situation for the new Executive Board

In many respects, the initial situation was good before the new Executive Board took up office in January 1999. Inflation was low and growth had got started in earnest after the crises in the early 1990s. This development in turn would not have been possible without an extensive budget consolidation and it had received good support from a strong international development with low inflation.

A lot had also happened in the area of monetary policy, with the ambition to be open and clear. Let me briefly comment the results concerning all the different aspects of openness and clarity I have just referred to – credibility, legitimacy, predictability and efficiency in the organisation.

Inflation expectations, as measured in surveys, showed that credibility had increased. For the long term they were parked around the 2 per cent target. (Diagram 1). Price-setting in the market showed the same picture. The implied forward ten-year interest rate was now more or less in parity with Germany, for instance, whereas three to four years earlier it had been two to three percentage points higher (Diagram 2). While the krona had been considerably weakened in the turbulence after the Asian crisis during autumn 1998, in a somewhat longer perspective it had still stabilised markedly.

There were also clear indications that the inflation target policy had received increased public support. Studies showed that understanding for our work had gradually increased and that 60 per cent considered we were doing a good job. (See table 1). This is also the impression obtained from the media, although that is naturally more difficult to establish. Perhaps it can also be said that the fact that the Riksbank was given statutory independence was an acknowledgement that the inflation target policy had succeeded, although the crucial factor underlying this decision was EU membership and the international consensus about the value of having independent central banks. This approach is spelled out clearly in the Maastricht Treaty.

Also with regard to communications with the market, the general picture was that developments were moving in the right direction. The Riksbank's actions were well understood. Comparisons of the actual repo rate with that forecast by the market show that they accord well. (Diagram 3). Accuracy is naturally poorer in a longer perspective, but this is mainly because there is time for the inflation perspective to change as a consequence of unforeseen events. On a few occasions, there had been some criticism of communication when the Riksbank realigned policy. Perhaps the best example of this is the discussion in June 1998 when we lowered the repo rate in a situation where many expected the opposite until only a few weeks before. The problem also existed in connection with the increase in autumn 1997.

I also underlined to begin with the value of transparency for our internal assessments and for inviting external analysts to a mutual, fruitful discussion. The results in this respect are not so easy to assess. Our regular assessments do not show a clear improvement in the forecasts. However, every situation has its forecasting problems and, looking back, it is not easy to tell which was most difficult. But we have clearly received a great deal of assistance from external economists from universities and the market in developing analytical frameworks and forecasting methods and that a dialogue with our critics has stimulated us to proceed and deepen our analysis to the best of our ability.

However, we were definitely having problems with the clarity of policy that needed to be tackled at the time when the new Executive Board was introduced. They concerned the formulation of our inflation target and how temporary deviations from it were handled in monetary policy. The Riksbank had struggled with this issue ever since the inflation target was introduced in 1993 but there was still quite a lot of confusion on this point. Our target was formulated in terms of inflation measured by the change in the consumer price index. During the years when CPI inflation fell short of the target, the Riksbank naturally came in for criticism. But the fact that, for good reasons, policy disregarded transitory effects in practice caused some confusion. We had repeatedly tried to explain this but it is a difficult question and we had clearly failed to get our message across. So there was clearly a case for changing the formulation of the target or clarifying policy in some other way. A proposal for these clarifications was worked out at the end of autumn 1998 and accepted in its main outlines by the Executive Board at the beginning of February 1999.

Another problem was that for a number of years and even excluding transitory effects, CPI inflation had still ended up below the target. We were therefore accused of carrying out policy in an asymmetrical way. There were, of course, many explanations for the low inflation, including rapid external changes that could hardly have been anticipated. It may also be the case that forecasting inflation is so difficult that discrepancies of this kind cannot be avoided. Nevertheless, there were also reasons for the Riksbank under the new Executive Board to aim for better inflation assessments.

The most urgent task we confronted was, however, to adapt the monetary policy decision-making process and communication in the new situation with six Executive Board members. An important starting point for our preparatory work

during autumn 1998 was that the members would make the monetary policy decisions collectively but with individual accountability. Individual responsibility per se was not explicit in the legislation except that each board member was appointed on her or his merits. In the light of this, however, we found it important that the individual initiatives and decisions could be evaluated, for instance in the context of re-appointment .

In a number of other countries there were experiences of similar decision-making structures and we therefore had extensive contacts with colleagues overseas. I visited inter alia the Bank of England's equivalent to our executive board with regard to monetary policy decisions – the Monetary Policy Committee. I also had extensive contacts with colleagues at the Bundesbank whose management in many ways resembles the Swedish Riksbank's and also has long experience of such matters.

On the basis of these contacts, our own experience and the relevant academic literature, we designed proposals for, among other things, the process of preparing decisions at the bank, the forms of work of the Executive Board and signalling. Regardless of who the members of the new Executive Board were to be, it would be important to establish these foundations in good time, so that the new Board could work efficiently without delay.

3. The internal process of preparing decisions

The proposals that were worked out during autumn 1998 centred on the Executive Board discussing monetary policy at meetings planned in advance and held 8-10 times a year. It was regarded as valuable both for the market and for the internal work to have a fixed timetable for the monetary policy meetings. We decided to meet more seldom than the monetary policy decision-makers do at, for instance, the Bank of England and the ECB. This was because relevant new information is not received so often that meetings need to be held at shorter intervals. In this way, we would have time to assemble a well –thought-out basis for each meeting. Of course, we can still meet at short notice and make decisions if the situation so requires.

It was proposed that the staff continue to have a strong role in the new decision-preparing process. The assessments on which the Board's discussions were to be based would continue to be worked out by the departments that had had this task to date. In order to secure as good and all-round a basis as possible, all assessments and monetary policy material were also discussed in the monetary policy group, which includes experts from different parts of the Bank.

The decision-making procedure has been developed and clarified since then. According to the cycle we follow today for the Inflation Reports, the issues that are considered to be most important for the next Report are normally discussed directly after the preceding decision-making meeting. A synopsis that may contain ideas about in-depth analyses and the theme of the next Report is usually scrutinised by the Executive Board after a few additional weeks have passed. The Economics Department thereafter produces a complete assessment of the economy and inflation which is presented together with alternative paths for the economy

and arithmetical examples showing the sensitivity of the results to various key variables. On the basis of this material, the Executive Board discusses the inflation perspective and establishes its view. The Economics Department then produces a draft of the Inflation Report based on the Executive Board's scenario. This is discussed and is confirmed in practice a week before the Report is published so that it can be printed. The day before the publication date, the Executive Board meets for a monetary policy meeting where decisions are formally made on the report, accompanied by a discussion of what the consequences should be for monetary policy.

Naturally, other preparatory procedures would be possible and there are also differences between us and our colleagues at other central banks. Still, most of them have opted, like us, for a fixed schedule of meetings and give their staffs the task of producing overall documentation and forecasts. The Bank of England, however, has chosen a slightly different approach. Their Monetary Policy Committee receives a very extensive review of new statistics and of the different staff assessments but no overall forecast. I understand that they decided to produce the forecast themselves so as to avoid being too influenced by the staff. Their approach probably also has to do with the fact that, unlike the boards of the Riksbank and the ECB, they are solely concerned with monetary policy and are appointed for this, with an outstandingly high economic competence.

Personally, I find it important to give the staff a strong position. Only then can high competence be upheld in the long run and continuity guaranteed. It is hardly by getting involved in the details of assessments that Board's members can make the best contribution to monetary policy. But the Board should highlight alternative perspectives and broaden the analysis. For this kind of discussion, overall assessments with alternative scenarios are a good starting point.

Now and then, proposals are made for making the role of the staff even clearer. This could be done, for instance, by publishing the staff's own assessments. However, such an arrangement is not as obvious as it might at first seem. My main objection is that it risks driving a wedge between the staff and the Executive Board. What happens when the assessments clearly differ and how does this affect the view of the Riksbank? Should the staff go out and defend their standpoints? Who should then draft the response of the Executive Board, etc.? Another issue is who constitutes staff in practice and why should just those persons be given a voice in the debate?

One very complex issue, which has become somewhat clearer recently in the academic debate and is clearly relevant for our work, is how an inflation assessment is to be made by a group. The logic of assessable individual responsibility argues rather in favour of each Board member presenting a separate inflation forecast, just as each member votes on the interest rate. However, this is manifestly not feasible. There cannot be a personal staff for each member, neither would we probably be able to make better individual assessments than the one produced by our staffs' collective efforts. Moreover, it is undoubtedly an advantage if the Executive Board can communicate a reasonably coherent majority picture, rather than a set of different views.

How to strike the balance, however, is not self-evident. One possibility would be for the Inflation Report to represent the majority view, with boxes containing any divergent opinions. A step further would be to present any divergent views in each section. To date, the Inflation Report has represented the majority view and any reservations have appeared in the minutes published some time after. However, for those wishing to be included in the majority, this normally makes demands on a willingness to compromise as our main scenario is constructed as a rather detailed picture and individuals can naturally differ about particular aspects.

4. Work and decisions in the Executive Committee

In that the members of the Executive Board are appointed on an individual mandate, we decided that our monetary policy discussions should be minuted. This was done mainly to facilitate the work of those who would appoint and assess us. At the same time, publishing the minutes of the meetings naturally means that previously confidential information about conversations and discussions in the Riksbank would now be available for external analysts. For evaluations, it was important to show how each member of the Executive Board voted. We also considered that it would be valuable to report the discussions in a relatively detailed form, although we never really considered revealing exactly what each person said, as that might inhibit discussion.

When the new Executive Board's decision-making model was made public, it encountered some criticism. Concern was expressed that the real discussions would take place elsewhere than at the minuted meetings in order to maintain the facade of unity and present a coherent message. Recently, however, the pendulum has swung and criticism now centres on the Executive Board having become a discussion club at Brunkebergstorg that is never unanimous. There was a similar debate when the Bank of England changed its system; but after a time the formula was accepted and it has been increasingly seen as natural that opinions in the Monetary Policy Committee differ from time to time.

Of course, it is not easy to find good forms for the discussion right away. We have been feeling our way and the organisation of the meetings has varied slightly over time. The best way of getting a good discussion started is to have a good all-round basis. But there is more to it than that. It is also important to achieve an open, frank discussion without considerations of prestige so that different ideas can be tested against one another. An open process with many people present in the room entails risks that everyone in the Executive Board needs to be aware of. How we communicate to the outside world is important in this context, as this can affect future internal discussions. In the light of this, we have decided to avoid criticising one another and our opinions in public. Instead, we concentrate mainly on a discussion of the future inflation perspective. Debates among us could easily escalate and affect our internal work. The latter would also be a problem in that, besides handling monetary policy, we jointly manage a relatively large organisation.

The media have periodically given the impression that our opinions differ all time and that the Executive Board can be divided into clearly identifiable hawks and doves. There are, of course, differences between us in background and values, as well as in attitudes to monetary policy, but the impression is still erroneous. The

differences of opinion have been relatively small and have mainly reflected different assessments of the specific macro-economic situation. As long as we all maintain that policy should be focused on the 2 per cent inflation target, there is no room for any hawkish or dove-like attitudes to exert all that much influence. That would mean advocating a policy that led to the target being systematically missed in one direction or the other. With regard to the repo rate, the largest difference of opinion to date has been 25 basis points. The number of reservations has also been lower than the average for the Bank of England's Monetary Policy Committee.

I believe that people must make up their minds on the issue of individual accountability and minutes. If we do not want to go back to a more closed arrangement – with the consequences that would have for the Riksbank's position in public debate, etc. – and it is decided to have members who are individually responsible for policy, the differences of opinion in the Executive Board and dissonances in the message must be accepted. Monetary policy is not an exact science, although the distinct inflation target has established a clear framework for policy. In the long term, I also believe that the discussions will generate a lot of good will. They clarify that monetary policy involves difficult judgements that one can have different opinions about and this can be of value for understanding the work we have to do. The collective decision-making can also reduce the fixation on a single decision-maker. Although the discussion to date has rather led to a closer focus on persons, it need not have this effect in the long run. The institution may then come to the fore in a clearer way.

5. Monetary policy signalling

In the preparatory work during autumn 1998, it was proposed that the Inflation Report would continue to play a key role in the Riksbank's communications. We also proposed that a press release or a bulletin should be published in connection with the monetary policy meetings. This would provide a direct report on how the majority on the Executive Board assessed the inflation perspective and motivate any decisions to adjust the interest rate. We anticipated that the minutes from the monetary policy meetings could be available a few weeks after the meeting had been held. They would also provide information as to how we viewed the inflation perspective and policy. The Reports, press releases and minutes would then be form the corpus of communication. Taken as a whole, these documents would provide considerably more detailed and regular information about the Riksbank's deliberations than had previously been the case.

In the Inflation Reports the Executive Board presents gives its view on inflation in recent years. It accordingly lays the basis for our monetary policy actions. For those who are interested in obtaining a view of how the interest rate is likely to develop in the longer run, the Report should be the key source. Work on the Report has also continued to develop and it now contains more information than before with which new information can be compared. On the other hand, the reports no longer contain discussions about the formation of monetary policy. This aspect is contained instead in the press releases after the monetary policy meetings and in the minutes. The minutes also contain information that was not previously available

on individual standpoints and issues discussed by the Executive Board which are not reflected in the Report or in press releases. The minutes are thereby important for evaluating what may happen at the next meeting.

In the light of each Board member being individually accountable for policy, it was natural to propose that everyone would be able to hold speeches or in other ways communicate their views on monetary policy issues. The rules of the game were thereby changed somewhat for those who had monitored the Riksbank. Previously, it was in practice only the Governor of the Riksbank and myself who spoke on behalf of the Riksbank on monetary policy issues. We did this after first discussing with each other and, of course, with regard to the main lines of policy with the then Governing Board. The Riksbank spoke in practice with one voice as against six voices today. Speeches are the responsibility of each individual member unless explicitly stated otherwise, which to date has only taken place applied to the Riksbank Governor addressing the Parliamentary Standing Committee on Finance twice a year.

Our experiences of the new system have been good on the whole. It can hardly be claimed that this has led to policy being tangibly less clear, although some criticism to that effect has been heard from time to time.

One possibility of shedding light on the issue is to again compare the actual repo rate with the market's repo rate expectations three months earlier (Diagram 4). There is really only one instance of a clear deviation, during the summer and early autumn, when expectations of a monetary policy tightening were built into market pricing even though the Riksbank had not given any such indications. One conceivable explanation is that a number of forecasters revised their growth assessments upwards both internationally and in Sweden when it was foreseen that effects of the Asian crisis would not be as extensive as initially anticipated. The short interest rate level then rose both globally and in Sweden.

Another reason for the dissonances between the Riksbank's actions and some market analysts at the beginning of autumn was probably that the majority of the Executive Board decided to use the time granted by the inflation assessment and motivate the coming need for an interest rate increase in detail and on a wide scale. This was intended to build up support for the policy but it can naturally have confounded analysts who did not consider this aspect and thought they saw the need for an increase early on.

We have also tried to shed light on whether signalling was clear and consistent in the sense that the same future approach to monetary policy was indicated by all members of the Board and whether the repo rate was changed in accordance with the indications given. If we compare the indications in speeches, minutes and Inflation Reports with the repo rate and the expected repo rate three months earlier in the period January 1995 to December 1999, we can note that the Board members seem to have given a consistent picture of monetary policy (Diagram 5).

Does our new procedure mean that it is impossible to give a clear indication of where the interest rate is moving? Not really. If we want to, we can ensure that a joint statement is made. It is also possible for individual members to send signals if they believe they can predict the Board's future decision. However, the latter

carries a some risk as the Board is sovereign at each meeting and can make any decision.

Let me finally underline something that may seem self-evident, but which nevertheless is often forgotten in the debate. We cannot be clearer than the situation permits. When there is considerable uncertainty, it is not possible for the Board to indicate a definite direction of monetary policy.

6. Summing-up and conclusions

After the crisis in the early 1990s, the development of the Swedish economy has been positive. Growth has been high at the same time as inflation has been low. Many factors have contributed to this. One is, of course, the high level of unutilised resources after the crisis. However, the relatively good international economic situation, with growth and low inflation, has also contributed, as has the extensive consolidation of the central government budget. Important measures for improving economic structures have also played a role, many carried out over the turn of the 1980s.

There are also good reasons to highlight the new approach to monetary policy. From January 1993, policy has been based on an explicit price stability target, which was controversial to start with. Support for this policy has gradually grown as it yielded good results. Last year, new legislation took effect which perhaps to some extent can be regarded as an acknowledgement of this.

Transparency and clarity have probably contributed to the increased support. The combination of a symmetric target, published forecasts and implementation of the rule of action that the interest rate is normally increased when inflation is above the target and vice versa have been important components of policy. In these respects I believe that the arrangements we have chosen may deserve consideration by other central banks as well. What we have done has probably:

- Contributed to credibility without having to wait for a long record of good results. An example of this is the interest rate reductions in autumn 1998, which we could motivate in a clear way by revising our forecasts and thus avoiding a debate of the kind that affected Europe at that time.
- Facilitated broad acceptance of the monetary policy regime in Swedish society. The ambition has been for the same simple pedagogical approach to be applicable for the sofa on a morning TV programme, at a Social-Democratic branch meeting in Skellefteå and at a seminar at Stockholm University.
- Facilitated policy interpretation and made it easier for market participants and others to predict policy,
- Contributed to a goal orientation of the internal work and opened the way for a meaningful, fruitful dialogue with critics outside the Riksbank.

However, these positive results do not mean that policy implementation has not posed problems. There has been uncertainty as to how we have dealt with transitory effects. We have also been below the target due to inaccurate forecasting. But the

Swedish experiences do not suggest that a central bank should abstain from openly publishing its assessments just because of the that forecasts or assessments may be mistaken.

At the Riksbank we are continuing to work hard on the development of our analytical framework and to become increasingly transparent and clear. Bit by bit, we should be able to extend our understanding of the relationships behind inflation, for example, and thereby also convey a clearer account of how the picture of inflation is built up.

In addition to transparency, transparency, the legitimacy of policy calls for accountability. By mooring policy to a clear target that can be evaluated, the Riksbank has facilitated assessments and accountability beyond the standard set by laws and ordinances. I find that a reasonable ambition for an institution that has so much power as has been conferred on the Riksbank.

The forms for decision-making and communication were changed with the new Executive Board. Minutes are now published after each meeting, mainly to make it easier to demand accountability. This has also led to the bank being more transparent, which was a debatable issue due to concern that the internal discussion might suffer and that the bank as an institution would be harmed. I can understand this concern to some extent and it is important to handle the new situation with care. At the same time, it should be borne in mind that the new arrangements will no doubt settle down after a time and then contribute to a more nuanced discussion about the considerations we have to make.

It is, at any rate, still too early for assessments in this respect. Neither can we draw any definite conclusions as to what experience in Sweden may imply for other central banks. As regards the forms for exacting accountability and anchoring policy, moreover, a matter of crucial importance is the political traditions, institutional set-ups and monetary policy experiences in other countries.