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Communications in Central Banks: A Perspective

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Abstract

Communication in central banking has become a very serious matter. Not long ago central banking was shrouded in mystery: decision making was seldom transparent and communication with financial markets minimal. Now central banks influence the economy as much through management of expectations as through policy actions.

The need for increased central bank communication has been influenced by a number of developments. As central banks have become more independent, transparency and accountability of their actions has become more important. Further, with the weight of traditional banking declining in the financial sector, monetary policy transmission takes place more through impersonal financial markets which requires greater communication. The task of central banks has become more complex as the objective of financial stability is added to those of inflation targeting and economic growth. The more complex the mandate of central banks becomes the more important the role of communication.

The Reserve Bank of India has such a complex mandate requiring clear communication with financial markets and the public. It does this through policy announcements, reports, regulatory communications, technical advisory committees, and interactions with the media. Transparency in operations is maintained through its website. Despite these communication channels, the Reserve Bank has experienced difficulty in maintaining effective communication: as it acted to curb financial excesses during the period prior to the recent global crisis, for example, there was little understanding of its actions.

As central bank operations become more complex, other central banks will face similar problems. Complex policy statements are often regarded as non-transparent, as markets, analysts and the public have become accustomed to simple objectives and statements. Simplicity has become confused with transparency. Thus central banks will face new communication challenges in the near future.

Keywords: Central banks; communication; India.

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I. Introduction

Communication is part of the professional hazards that central bankers face as a routine. The responses as well as policy actions are mostly ‘measured’. Financial markets watch their pauses, and some punctuation marks in the text of a statement have the distinct possibility of getting transmitted through the movement of a few points in the yield curve. Faced with such grave consequences that can be measured in millions of rupees or dollars, communication in central banking becomes a very serious matter.

Is it true for central banking only? Perhaps not: after all, communication in general is a complex process. While we all attempt to communicate among ourselves all the time, nonetheless, the expression of intentions in verbal or written mode often do not get transmitted correctly to the reader or listener. Words have different connotations - so have paragraphs or lengthy documents. The reader or listener often ascribes motives to expressions used and a wedge is created between what is said and what is perceived. What a person perceives is often very dependent on what she expects to hear, or she wants to hear. It interesting to refer to what William Poole has noted in the context of central bank communication,

"Accurate communication requires settled meanings for words. For any given word, we can consult a dictionary and we usually discover that each English word has several meanings, which can be quite different. There is no dictionary in which we can look up the several meanings of a paragraph. The meaning of a policy statement — preferably only one — must be established by the central bank, through consistent practice over time and through more extended discussion of what the language means" (Poole, 2003).

Furthermore, expression of intention is not a one-off affair; on the contrary there are elements of incrementality in communication and reputation plays a role. Illustratively, my children often start reacting to any directions only after a reminder: their normal reaction to my directions is to see whether I was serious to begin with. My credibility is constantly at stake.

What is different about central bank communication is that it can move markets and influence large losses or gains from possible missteps in communication. Communication in central banking is thus a far more difficult process. It is not that long ago that central banking was shrouded in mystery. Books like “Secrets of the Temple” (Greider, 1989), and expressions like “monetary mystique” (Goodfreind, 1985) bear testimony to this. It was in fact widely believed that communication from the Central Bank needs to be couched in terms of “constructive ambiguity”, a term coined by President Gerry Corrigan of the New York Fed. One is reminded of what Alan Greenspan said, “The undeniable, though regrettable, fact is that the most effective policymaking is done outside the immediate glare of the press” (Greenspan, 2002).

In an excellent review of central bank communication, Alan Blinder (2009), a former Governor of the US Federal Reserve, reminded us of the mystery that surrounded central banking by quoting Karl Brunner (1981, p. 5)
Central banking… thrives on a pervasive impression that [it]… is an esoteric art. Access to this art and its proper execution is confined to the initiated elite. The esoteric nature of the art is moreover revealed by an inherent impossibility to articulate its insights in explicit and intelligible words and sentences.

It was felt earlier that policy effectiveness depended on the degree of surprise with which the market was taken by central bank policy announcements. In fact, it is quite remarkable to note that prior to 1994 the target Federal Funds Rate was not even announced by the US Federal Reserve: the market was left to infer the rate from the timing, sequence and magnitude of its open market operations (Woodford, 2005). Now, however, the U.S. Federal Reserve not only announces its current target Fed Fund Rate but it also provides a relatively clear indication of the likely trajectory of future interest rates. Such has been the revolution in Central Bank communication practice over the last ten to fifteen years.

Since the late 1980s and early 1990s the widely perceived iron wall of central banks’ communication has become much thinner, along with the fall of the iron curtain. From the current vantage point we can clearly discern four reasons for this change:

- First, the clamour for and attainment of central bank independence has imposed a great degree of responsibility on central banks – a major one being the attainment of transparency in communication.

- Second, adoption of inflation targeting by a number of central banks since the 1990s made effective communication an integral part of policy making. Monetary policy committees were formed and minutes started being published. Effectiveness of this policy is thought to be strictly influenced by better communication and credibility of the central bank.

- Third, the innovations in information and communication technology made the speed and form of communication from central banks quite revolutionary. From the print medium and television the new entrants of transmission have been the websites of the central banks and the wire agencies like Reuters and Bloomberg.

- Fourth, with the growth in importance of impersonal financial markets and the relative decline of banks in overall resource allocation in an economy, in order to achieve their goals central banks have to communicate effectively with the amorphous mass of financial market participants, rather than just with banks.

Characterizing the change in thinking, Alan Blinder quoted his own 1996 Robbins lectures at the London School of Economics on what central bank communication should be,

Greater openness might actually improve the efficiency of monetary policy… [because] expectations about future central bank behaviour provide the essential link between short rates and long rates. A more open central bank… naturally conditions expectations by providing the markets with more information about its own view of the fundamental factors guiding monetary policy…, thereby creating a virtuous circle. By making itself more predictable to the markets, the central bank makes market reactions to monetary policy more predictable to itself. And that makes it possible to do a better job of managing the economy. (Blinder (1998), pp. 70-72)
This change in thinking has occurred with the enhanced perception that "central banks affect the economy as much through their influence on expectations as through any direct, mechanical effects of central bank trading in the market for overnight cash" (Woodford, 2005), or through their specific announcements on the intervention rate. Woodford goes as far as to say that "Central Banking is management of expectations". When a central bank changes its intervention / policy rate, its effectiveness in influencing key variables such as the inflation rate depends crucially on its effect on other financial market prices such as the exchange rate, equity prices and the longer term interest rates. Thus, apart from the specific action related to the overnight policy rate, the central bank has to use all the means at its disposal to achieve its policy aims. Now that direct credit controls, or other quantitative direct instruments are not generally used, and that financial markets have deepened even in emerging market economies (EMEs), effective communicative of central bank policy objectives, instruments and action has gained prominence.

In fact, currently there is perhaps an abundance of information that gets transmitted from the Central Banks to the public. This occurs to the extent that the Economist (July 22, 2004) raised the question: “Do communicative central banks make financial markets lazy?” and concluded that, “It’s not always good to talk.” This is the kind of tension that pervades central bank communication. On the one hand the effectiveness of central banks depends crucially on their credibility. On the other hand, enhanced credibility implies that financial market participants set great store on their projections, thereby possibly resulting in group think. It can then happen that, effectively, private market participants are actually outsourcing risk management to the central bank. For example, it is argued by some that the forward guidance given by US monetary authorities contributed to the considerable underpricing of risk that was an important ingredient of the unfolding of the global financial crisis. Thus, the extent to which central banks should give forward guidance remains a subject of active debate.

As argued by Blinder (2009, p. 2), “There is no role whatsoever for monetary policy communication in what might be called the pure rational expectations paradigm.” If market participants have rational expectations about the future and if the central bank is committed to an unchanging policy rule the market will always anticipate monetary policy actions, and hence there would be no role for the central bank. Economic and market reality is different: there are information asymmetries between the central bank and market participants and among them; the central bank may have to change its mode of operation in response to unexpected economic developments or market related events, and so on. Thus the need for effective central bank communication is constant.

The issue at hand for our countries relates to our understanding of the depth and sophistication of our financial markets and of the public at large. Should our communication strategies be similar to that of our counterparts in more developed countries? Should our mode of monetary policy making, e.g. inflation targeting, be similar to the current vogue elsewhere? How confident can we be of our powers of modeling and forecasting? These are the questions that we have to deal with and to then fashion our communication strategies accordingly.

It is in this context that I attempt to review the rationale, forms and practices of communication in central banking and to try to evaluate the Indian experience in this paper.
The rest of the paper is organized as follows. Section II looks into the general issues relating of communication in central banks. Section III presents the Indian practices and some of my personal reflections in this regard. Section IV gives concluding observations.

II. Necessity of Communication from the Central Bankers

The issue of communication in central banks is intimately interlinked with the mandate of the central bank. The more complex is the mandate of the central bank, the more difficult as well as more important is the communication. Illustratively, if the mandate of the central bank is either inflation targeting or exchange rate targeting (as in a currency board arrangement) then the objective of the central bank is amply clear to the public. Hence communication is necessary to express the commitment of the central bank which is reflected through continuous action to maintain its credibility for achieving these objectives. On the contrary, if the mandate is complex as it is, for example, for the US Federal Reserve and the Reserve Bank of India, then communicating these objectives and how they are to be achieved becomes much more difficult. Moreover, even if the objectives are known, when there are multiple objectives there could be lack of clarity among the relative weights and the changing relative weights of these objectives. In all such cases, the central bank needs to communicate its objectives on a continuous basis. Thus, the benefit of central bank communication depends crucially on the adopted policy approach (Bernanke, 2004). Specifically if the central bank follows a simple feedback policy, then the private sector can easily infer its future policies. In that case, there is no necessity of extensive communication by the central bank except when the central bank decides to deviate substantially from the rule. Central bankers in modern times hardly follow a simple feedback rule – all central banks, including the inflation targeters, take into account a wealth of information in deciding the future course of monetary policy and follow what is termed the ‘forecast-based approach’. In this case, the public is unable to infer the likely course of policy easily and so needs guidance about the central bank’s perception of outlooks, risk assessments, and objectives. Clear and transparent communication plays an important role in this case.

The need for communication from the central banks also comes from another distinct source. Since the early 1990s, there is an increasing emphasis on central bank independence. In a democratic polity, a good deal of trust is placed in the central bank. Various countries have attained varying degrees of independence of their central banks. In this context, questions of accountability and transparency are often raised. Communication is at the heart of accountability. There is, thus, a need to understand motives and procedures. When the political authorities give a clear mandate to the central banks in bestowing independence then the communication policy of the central bank is reasonably clear. A crucial issue about communication policy is when and with whom to communicate with. Interestingly, when a central bank is not independent, then it can communicate only to the controlling authority. In case of an independent central bank the communication has to go to various actors, viz., (a) the public, (b) the legislature or executive, (c) market participants. The mode and method of communication to the participants would be distinctly different for these three entities.

1 As for example, a CEPR (Centre for Economic Policy Research) document visualized the Bank of England as “independent and accountable” [Roll and others (1993)].
In a globalised world, it is impossible to formulate monetary policy independent of international developments. Monetary policy formulation has, thus, become more complex and interdependent (Mohan, 2002). Furthermore, with increasing communication from the regulatory agencies like the Bank for International Settlement (BIS) or the International Monetary Fund (IMF), sophistication of the staff in central banks is perhaps not too different among the countries. The question, however, is: how sophisticated is the audience in understanding delicate nuances of the announcements of the central banks. In fact, the effectiveness of monetary policy will depend crucially on how well the public and market participants understand the central bank signals. A related question is: do the central banks need to communicate to different agents differently? What is good for the public may not be good for the market participants. After all, “the markets thrive on volatility, while the public dislike it quite intensely” (Blinder et al., 2000).

It is argued by some that monetary policy is most effective when markets anticipate it correctly. Thus, a general consensus in the literature has been that the more transparency there is the better. More open public disclosure of central bank policies may enhance the efficiency of markets, through the following two channels:

- First, greater information about how a central bank makes policy decisions helps to reduce financial speculation.
- Second, clearer decision rules help to reduce the volatility of markets, and, thus, enhance the predictability of future movements in the prices of financial assets.

Furthermore, as the rational expectations literature has taught us that the effects of a given policy action have to be defined within a treatment of policy expectations. It is argued that an assumption about public understanding of the future course of policy is a precondition for any coherent analysis of current policy. Monetary policy is no exception to this general rule. Besides, this literature also showed that monetary authorities cannot utilize the short-run trade-off by “fooling” the public systemically, and thereby established the necessity of transparency in communication by central banks.

The forex market, because of its special nature, could be an exception to this general rule of ‘more the merrier’ in case of transparency. Communication in the area of exchange rate policy is special for a number of reasons (Blinder et al., 2000). First, apart from central banks, governments frequently have joint responsibility for exchange rate policy. Second, in the case of some exchange rate arrangements (such as, pure pegs and pure floats), the need for central bank communication is absent. Third, in some instances where central banks decide to intervene in the foreign exchange market in pursuit of monetary goals, secrecy may be defensible on the grounds of effectiveness. I shall turn to this issue in the Indian context in somewhat greater detail.

Another general issue is that despite the multiplicity of objectives there is usually only one instrument that the central banks generally use, viz., a variant of the short-term interest rate. Central banks all over the world try to change the short-term interest rate assuming that it will also influence the medium and long term interest rates - after all it is the medium and long term rates that affect expectations and asset prices (Blinder, 1998). To a large extent, this happens through explanations or forecasts. The effectiveness of these will depend crucially on the degree of sophistication of financial market participants and their interlocutors. For this one instrument to work effectively, financial markets have to be
efficient, deep and liquid for continuous price discovery to take place in response to central bank actions.

With the unfolding of the global financial crisis in 2007-08 central banks all over the world have had to undertake a series of unconventional actions in terms of liquidity injections, monetary and credit easing. As financial markets froze, the traditional short term policy rate was brought down to near zero levels and hence policy alternatives had to be used progressively to cope with the crisis. Central banks also had to dust off the other instruments in their toolkits, particularly their role as lenders of last resort. As the markets froze, some also had to operate directly in the credit market by buying asset backed securities, commercial paper and other instruments that a central bank would not normally take on its balance sheet. There is also now increasing discussion on the use of macro prudential measures to address asset price booms and busts. The increased use of multiple instruments could lead to further complexities in central bank communication.

The extent of transparency in central bank communication has been dictated by the norms of openness in the body-politic as well. Illustratively, the Bank of England (BoE)’s information dissemination is governed by the Freedom of Information Act 2000 of the U.K. This Act places an obligation on public authorities to adopt and maintain a publication scheme. Furthermore, with effect from January 2005, the Act provides a general right of access to all types of recorded information held by public authorities and sets out exemptions from that right. Similarly, the Freedom of Information Act is applicable to activities of the US Fed as well. More recently, of course, with the enactment of the Right to Information Act in India, the Reserve Bank is also subject to it and all information can be sought on all its activities. The only exception applies to activities and discussions the disclosure of which could affect the economic security of the state.

Do central banks talk in an obscure language? Is communication an exercise in obfuscation? Many of the central banks have traditionally been portrayed as tight-lipped, secretive, and cryptic. It is often alleged that central bank executives use complicated words to convey little meaning. Blinder and others have alleged that, “Chairman Alan Greenspan is credited with raising Fedspeak to a high art … even characterizing his own way of communicating as mumbling with great incoherence” (Blinder et al, 2000). In one particular incident, Chairman Greenspan is reported to have told a US senator, who claimed to have understood what the chairman had just said, that “in that case, I must have misspoken”.

Notwithstanding the expression of such views, there has been great progress in fostering transparency in central bank communication in recent years. A case in point is the publication of minutes of the Monetary Policy Committee of the Bank of England. According to the Bank of England Act, 1998, the BoE is supposed to "publish minutes of the MPC meeting before the end of the period of 6 weeks beginning with the day of the meeting." Until October 1998 the minutes were published about five weeks after the meeting. The Monetary Policy Committee announced in 1998 that it would publish the minutes of its monthly meetings on the Wednesday of the second week after the meetings take place. Apart from the minutes, they publish the voting pattern of the individual members as well.
Besides, central banks are increasingly learning to communicate ‘perception of uncertainty’, as different from ‘ambiguity’. In terms of communication there are various ways to tell the public that ‘we do not know for certain’, which are clearly preferable to couching a statement in ambiguous language. Illustratively, the BoE publishes its growth or inflation forecasts with a specified margin of error – what is popularly called the “fan chart”. The fan chart with its increasing lighter shade (at the outward direction) is a mode that attempts to communicate the extent of uncertainty and the degree of ignorance of the forecaster.

Another important hallmark of modern communication is the emerging roles of web-sites and wire agencies. Although the speed of communication is still slightly slower than light, wire agencies put the communication from the central banks on an almost real time basis. This has great ramifications on the transmission of news and formation of expectation in the financial markets.

Having delineated the general principles let me now turn to the Indian specifics on central bank communication.

III. Communication by the Reserve Bank of India

I have already pointed out that the more complex the mandate of the central bank greater the necessity for communication. The Reserve Bank does have complex objectives. Apart from pursuing price stability and growth, financial stability is one of the overriding concerns of the RBI. Within the objective of monetary policy, both control of inflation and providing adequate credit to the productive sectors of the economy so as to foster growth are equally important. This apart, the Reserve Bank acts as a banking regulator, debt manager, government debt market regulator and currency issuer. Faced with such multiple tasks within its complex mandate, there is the utmost necessity for clear communication from the Reserve Bank of India.

What does the RBI need to communicate? In a central bank, there are three kinds of essential communication: (a) the content of policy measures, (b) the reasons behind such policy measures and (c) analysis of the economy. The RBI is engaged with all three kinds of communication. In fact, by international standards the Reserve Bank of India (RBI) has a fairly extensive and transparent communication system. Until July 2005, the RBI issued bi-annual policy statements that communicated its stance on monetary policy for the immediate future of six months to one year. From July 2005 onwards the RBI also appointed the Technical Advisory Committee on Monetary Policy (TACMP) as a surrogate for a Monetary Policy Committee (MPC). An MPC is usually empowered to make monetary policy decisions that are binding. This is easier to do when there is only one instrument on which to decide. Moreover, most MPCs consist of full time members who therefore bear institutional responsibility for their decisions. In the RBI’s case it uses a vector of instruments in its policy making, and the outside TACMP members have other responsibilities in their respective fields. Thus the outside members cannot be responsible for decision making and the TACMP has to be an advisory body.
**Communication of Policies**

RBI’s policy statements provide a full assessment of the emerging economic developments in India and also in the world. It also provides a rationale for the actions taken, which include monetary policy, regulatory and developmental measures. In addition, the RBI also issues a separate review of macroeconomic developments one day prior to the statement, and which it shares with the TACMP in its deliberations at least one week prior to the policy statement. This review, issued quarterly with the monetary policy statement, provides details of how the RBI sees the economy.

With the predominance of banks in the Indian financial system, the RBI has traditionally convened a meeting of leading bankers where the Governor formally announces the policy, and personally explains at length the rationale behind the measures taken. These policy meetings are not one-way traffic. Each banker present in the meeting interacts with the Governor to express his or her reaction to the policy announcement. After the policy announcement is released, the Governor addresses a press conference in the afternoon. The Deputy Governor in-charge of the Monetary Policy Department normally gives live interviews to all the major television channels on the same day. The Governor also gives interviews to print and electronic media over the next few days after the monetary policy announcement.

Prior to the quarterly formulation of policy a series of consultation meetings is also held with representatives of the major segments of the financial sector – banks, the foreign exchange market, money market, and debt market participants. Among banks, consultations are held with representatives of the large commercial banks and also with those of urban cooperative banks and rural cooperative banks. A new practice introduced in 2009 is also consultation with a selection of economists and economic journalists. Furthermore, the economics department also has a consultation meeting with major forecasters in order to compile information on economic forecasts available in the economy. Another set of consultation meetings is also held with representatives of national industry associations and of exporters in order to get a credible real sector view of economic developments and their expectations. Thus, over the years, as financial markets have become more complex, the RBI has attempted to ramp up its efforts to communicate on a systematic basis with all segments of the market.

Apart from these policy statements communication of RBI policy takes place through the speeches of the Governor and Deputy Governors. These speeches are devoted to issues concerning the economy as well as articulation of the RBI’s policies. Interestingly, globally it has been found that the speeches of the Governors of the central banks have been an important determinant of the movement of the term structure of interest rates (Fracasso, Genberg and Wyplosz, 2003). All of these speeches are disseminated immediately on its website and published subsequently in its Monthly Bulletin.

**Regulatory Communication**

The typical mode in which RBI’s policy is communicated to the regulated entities is through departmental circulars. Depending on the domain of operations the concerned department will issue a circular which is then placed in the website without delay. A typical complaint about the circulars is often that they are written in language that is not
easily comprehensible, and one needs to translate them into normal straightforward language.

There appears to be a tradition of framing official regulatory circulars in India in somewhat archaic legal language. Authorities in many countries have begun to attempt to frame official formal statements in simple language. The RBI has also begun this process and every circular now goes through a review by a group drawn from regulated entities. This is a process that can be taken further in the interest of better communication.

**Formal Reports**

The other major mode of dissemination of RBI policy as well as its views on the economy is through its reports. Over the years these reports have turned out to be more analytical, transparent and forward looking in their outlook. The two statutory reports of the Bank, the *Annual Report* and the *Report on Trend and Progress of Banking in India* have evoked immense interest among the public, market participants as well as in academia. The theme based *Report on Currency and Finance* is a platform to articulate the research findings on an issue of topical interest. *RBI Occasional Papers* has also emerged as a professional journal of refereed research output of the RBI staff.

Over the years Committee Reports have emerged as another plank of communication from RBI. The plethora of committees formed by the RBI tries to communicate to the financial sector participants or markets. Interestingly, many of these committees are conceptualized during the process of either the annual or the mid-year Review of monetary policy, so that by the time of the next policy its recommendations are available for consideration or for implementation. While the general public is quite cynical about the formation of any committee, as long as the authorities are serious about a transparent acceptance or rejection of the recommendations of committees, they are important for communicating collective policy thinking.

**Other Modes of Dissemination**

An important feature of the RBI communication policy is the almost real-time dissemination of information through its web-site. The daily results of the Liquidity Adjustment Facility (LAF) are posted on the web-site by 12.30 P.M of the same day, by 2.30 P.M the reference rates are also placed on the web-site. By the next morning the press release on money market operations is out. Every Saturday by 12 noon, the weekly statistical supplement is placed in the web-site, giving a fairly detailed recent database on the RBI and the financial sector. By the first of every month, the RBI Bulletin of the month is out. All the regulatory and administrative circulars of different Departments are placed on the web-site within half an hour of its finalization.

Another significant step towards transparency of monetary policy implementation is formation of various Technical Advisory Committees (TACs) in the RBI with representatives from market participants, other regulators (like SEBI or IRDA) and experts. Over the years, three such Technical Advisory committees have emerged – one on the money, forex and G-Sec markets, another on regulation; and the most recent on monetary policy. These fora act as platforms where RBI becomes familiar with the needs of market players and where the RBI is also able to communicate its stand on these issues, which may not be feasible in the formal modes of circulars. Many of the agenda notes prepared for
these meetings form the background of the monetary policy announcements. These apart, the Deputy Governor in charge of monetary policy holds annually detailed discussions termed “Resource Management Discussions” with managements of the largest commercial banks on an individual basis. Although these discussions have their roots in the earlier era of credit allocation, they are still useful in two-way communication between the central bank and the leading commercial banks.

There is one other platform for communication which is unusual for a central bank. In its role as a debt manager of state governments in India, the RBI has a vital interest in the fiscal prudence of state governments. The Deputy Governor in charge of debt management has held semi-annual meetings of state government finance secretaries for over 10 years. This has emerged as a very useful platform for the RBI to communicate its concerns to all state governments, and to understand theirs. This forum has also served as a neutral platform for discussion and communication between state finance ministries with the RBI and the Ministry of Finance.

I have tried to give a brief description of the various means and modes of communication strategy and policy of the RBI. Needless to say, in tune with the global trends, the RBI too has become more transparent, articulate and fast in communicating its policies and views on the economy. Nevertheless, questions remain. Could the RBI have done better? What else could have been done? What are impediments and hazards of communication in a central bank? How fast does the market react to central bank’s announcements? Let me now turn to some of these issues.

Effectiveness of Communication

How fast does central bank communication influence the market? An interesting illustration of the impact of central bank communication is perhaps the episode in the stock market on May 17, 2004. On this day, in the wake of change of Government, stock markets in India witnessed a record fall in price, which triggered the index-based circuit breaker twice during the day. The index-based circuit breaker triggered for the first time at 10:16 AM when the Sensex touched a low of 4516. When trading resumed after one hour at 11:15 AM, the Sensex opened at 4448 before touching the day's low of 4227 at 11:19 AM – which triggered the circuit breaker for around two hours. In normal circumstances, the Reserve Bank does not take a view about the stock market. However, when confronted with the possibility of a spill-over in money, G-Sec and forex markets RBI intervened on that day and two separate press releases were issued by the Bank, (a) indicating the constitution of an internal Task Force under the Executive Director, Financial Market Committee to monitor the developments in financial markets, and (b) assuring availability of Rupee and Forex Liquidity (Annex).

Thus, the RBI communicated that it was keeping in touch with major settlement banks and the stock exchanges to ensure that payment obligations on the exchanges were met and gave assurance of selling dollars through agent banks in order to augment supply or intervene directly to meet any demand supply imbalances. These press releases were placed on the web-site around 2.00 P.M, but were released to wire agencies half an hour earlier and were flashed in all the tickers by 1.30 P.M. Trading had resumed by that time at 1:16 PM; subsequent to the flashing of the press release, the market witnessed a quick recovery, before closing at 4505. Whereas it would be difficult to claim that the entire recovery in the
Sensex on that day to be solely due to the communication from the RBI, it is important to understand the role and power of such communications. There are occasions when central bank communication can have immediate impact on the market – that too on a market that is not strictly under its jurisdiction, but the stability of which is important for the maintenance of overall financial stability, and hence of interest to the central bank.

Central bank communication has its flip side too. The modern day paparazzi – syndrome affects central bankers as well. During my years at the RBI, as the Deputy Governor in charge of monetary policy, financial markets and for part of my tenure for debt management and forex reserve management, I had the experience of being followed regularly by a posse of newswire reporters wherever I happened to visit in India. This is heady stuff for any senior official and care has to be taken not to take any missteps in casual interactions. I am sure that many central bankers have encountered occasions when they have found statements attributed to them in the electronic or print media the next day that contrary to what they may have actually said. Let me illustrate this from a personal recollection, one of the very few that I experienced during my stay at the Reserve Bank. By and large, however, I have found the regular reporters to be very responsible.

On August 14, 2004 I was at the Annual Citibank-Fitch Debt Market Conference. On my entry I was chased by the journalists and one of the questions I was asked was about the future rate of inflation. To the best of my recollection I said that the then rise in inflation was predominantly driven by supply-shocks and that we were monitoring the developments carefully. To my utter surprise, a pink paper on the next day (i.e. Independence Day, August 15, 2004), reported a story with the photographs of the President of India and mine side by side, with the following catch lines:

- “President APJ Abdul Kalam said on Saturday that sustaining a high eight per cent growth and containing inflation, now at 7.61 per cent, were the major challenges for the country.”
- “Meanwhile, Reserve Bank (RBI) deputy governor Rakesh Mohan on Saturday reiterated that the authorities were expecting inflation to fall to the earlier levels of five per cent.”

The story implied that a Deputy Governor of the RBI differed with the President of India on the stance of inflation on the eve of the Independence Day! However, I was absolutely in a catch-22 situation and was unable to issue a letter of protest as it would have given the signal that the RBI is expecting the inflation to go up. Such are the travails of central bank communication!

Similar experience is often found in interpretation of various reports and policy statements. I am told that in recent years, the Bank of Canada has instituted a media “lock-up” arrangement in which the media can read key reports of the Bank of Canada and write their stories prior to the official publication time. There are regular media briefings during this lock-up period, where officials can deal with technical questions and clarify other issues (purely on an unattributed basis) for the media. In Canada such practice have resulted in a clear improvement in the in the quality of the reporting. I am aware that in RBI as well, the Reports are released to the media before the release date but without any technical briefing. Perhaps the RBI can think of introducing this media lock-up arrangement inclusive
of technical briefing in RBI. This could reduce the work of issuing rejoinders about some perceived misgiving on central bank policies.

In common parlance, central communication is often seen in an insider-outsider context. It is assumed that central bank communication refers to what the central bank chooses to tell the general public, market participants, experts, or the media. What happens to the communication internally? Or, to borrow from the management literature, how do we “sell the brand inside” (Mitchell, 2001)? While information flows to the employees in form of memos and newsletters, on many an occasion the employees of the organization are unable to appreciate the specific nuances embedded in these communications. Central banks are no exception to this general trend of the corporate world. The policy and research wings of the RBI would need to pay particular attention to the dissemination and effective communication of the RBI policies to internal staff and play a pro-active role.

In retrospect I have to plead mea culpa on this issue: I do believe we senior managers in the RBI have traditionally made inadequate efforts in this regard. The RBI has regional offices in every state and many departments in its central office as well, thus complicating the task of internal communication. Possible suggestions can include:

- The arrangement of internal seminars / talks in all regional offices and training colleges of the RBI after monetary policy announcements or publication of important Reports – whether regular (e.g., Annual Report or Report on Currency & Finance) or Committee Reports.

- The release of FAQs (frequently asked questions) on the website on any policy matter. There could be the provision of educational resources as well, as is done by the US Fed (such as, “In Plain English: Making Sense of the Federal Reserve”, or material on personal financial education).

- Introduction of a working paper series with a clear disclaimer that ‘these are the finding of the individual researcher and not of the RBI’. The unfortunate thing is that the disclaimer is often disregarded and any research finding is usually ascribed to the RBI.

With the increasing availability of electronic communication at low cost, much more can be done to improve internal communication in this fashion. Given that the time of top management is unavoidably limited, innovative ways will have to be found to accomplish this.

While the management normally makes policy statements to the outside world, in an increasingly liberalizing economy, staffs often act as ambassadors of the institution – in that sense internal communication could act as a conduit for external communication as well.

A look at the communication policy of the central banks in advanced countries brings out two important features. Many of the central banks have a monetary policy committee with some form or the other, and many of them have an inflation report and a financial stability report. The question is: how much do we need them? Although the Inflation Report is a hallmark of many inflation targeting economies, it is by no means universal – the same is also true for financial stability reports. Nevertheless, a vital question in this context is publication of the central bank’s forecasts. Almost all central banks have some internal forecasts of the inflation and growth rates of the economy. The inflation
targeting countries tend to attach heavy emphasis to the publication of forecasts. These forecasts are based on some economic models, and buttressed by the policy maker’s expectations. Thus, when and if, there is thinking on introducing an inflation report for India, it will be necessary to decide whether a detailed macro model is essential as a base for the report. Furthermore, thinking will need to be devoted on the kind of inflation targeting or projections that would be communicated. Would there be commitment to a band of inflation or to a point target? Would projections be given for an expected path over time or only for a specific point in time? On the issue of producing a financial stability report, the Report on Trend and Progress of Banking in India introduced a chapter on this topic in 2003-04. With the experience gained over the years, and after the comprehensive Financial Sector Assessment Report (FSAP) issued in 2009, a Financial Stability Report is now to be issued on a regular basis.

IV. Concluding Observations

The global financial crisis has resulted in much new thinking about central banking, the conduct of monetary policy and financial regulation. Many of the countries whose authorities were regarded as models of best practice have suffered the greatest impact of the crisis. In the field of financial regulation the Financial Services Authority (FSA) of the U.K. was often put forward as the model for a unified financial regulatory authority practicing light touch regulation. The FSA has itself repudiated its former practices and is now arguing for intrusive regulation. Similarly, inflation targeting that ignores asset prices is now being questioned. The adoption of inflation targeting is believed to have enhanced central bank credibility, reduced inflation and facilitated central bank communication. Again to quote Blinder (2009, p. 13), “Surprisingly, Ball and Sheridan (2005) find no empirical evidence that inflation targeting (IT) improves inflation performance in a cross section of countries, once you control for regression to the mean. (High inflation tends to come down.) … Countries that adopted IT had above average inflation prior to adoption.” He concludes that, “there appears to be no systematic difference in the inflation performances of successful countries with and without explicit inflation targets.”

As these issues are debated and resolved in the years to come, central bank communication will also undergo inevitable changes.

In retrospect, the RBI, in both its monetary policy and financial regulation functions, was acting over the past few years with a specific eye towards the maintenance of financial stability, along with its objectives of maintaining price stability and promoting growth. It took actions to curb the use of complex derivatives, to restrain the expansion of non bank financial institutions, to slow down excessive growth in housing finance and real estate lending, and to tighten monetary policy through means other than simple adjustment of short term interest rates. While taking all these actions, it also managed to promote the highest economic and credit growth over any five year period during 2003 to 2008. Yet, throughout this period it was subjected to withering criticism from both the press and a good segment of academia.

Was this a failure of communication? Why was RBI’s top management unable to persuade the public, financial institutions and analysts that it was acting in a prudent
manner and not restricting sustainable growth? This is an issue that deserves close analysis by communication specialists as well as by RBI’s top management.

Some international institutions, e.g. the Bank for International Settlements (BIS) were also drawing attention to the unsustainable nature of the financial expansion taking place in the advanced economies, but little heed was paid to their pronouncements, despite their acknowledged role as the central bankers’ apex club. Similarly, the “Great Moderation” and inflation targeting were celebrated worldwide, despite very high volatility in asset prices and exchange rates over the most recent decade or so.

So the question arises: when the party is in full swing, and the punch bowl is taken away by some authorities, can effective communication actually succeed in convincing the public and markets that the right measures are being taken?

Another issue that arises is related to the complexity of communications. As monetary policy was simplified to the single objective of price stability and use of the simple instrument of short-term policy interest rates, the markets and analysts alike began to expect simple, easy-to-understand policy statements. That the economy is an inherently complex organism began to be forgotten. Thus complex policy statements have come to be regarded as bad for communication and lacking in transparency; simplicity has begun to be confused with transparency.

As the world has entered more difficult times and as both fiscal and monetary policies being practiced now have become more complex, new challenges will have to be faced by central banks in their communications with the markets and the broader public.

Central Bank communication has come a long way. The traditionally secretive central bankers are now alleged to be talking too much. Central banks have become more transparent and today there is abundance of material about the central banks’ intended action plans.

What is the message then? Nobody doubts the necessity for more and transparent central bank communication. The question is: how do we go about it? In conclusion, I can do no better than to quote from Adam Posen of the Institute of International Economics, who succinctly summarized the need for central bank communication:

“Think of the relationship between a central bank and the attentive public as analogous to the relationship between a married couple. Good communication is key if the relationship is to cope well with the bumps and bruises of everyday life. While familiarity removes the need for too much explicitness in communication, changing surroundings and personal needs over time make it dangerous to take too much previous understanding for granted. Presumably, the relationship is for the long-term and day-to-day misunderstandings do not imperil the relationship, but they can make it less pleasant or mutually beneficial” (Posen, 2002, p. 3).
Annex

Two Press Releases from the RBI on May 17, 2004

Date: May 17, 2004

Availability of Rupee and Forex Liquidity

The Reserve Bank of India is closely monitoring the developments in the stock markets and the other financial markets and stands ready to provide sufficient liquidity to the banks for meeting all their payment obligations including for any intra-day requirements.

A Task Force has been constituted under the Executive Director, Financial Market Committee (Smt. S. Gopinath) and it can be contacted for any clarification/assistance at 22614228 and Fax No.22657604.

In the light of current developments in the foreign exchange markets, as at some previous occasion, the Reserve Bank of India has decided to take the following actions:

The Reserve Bank will continue to sell dollars through agent banks in order to augment supply in market or intervene directly to meet any demand supply imbalances. All the transactions by RBI will be at the prevailing market rates as per the market practice. FIIs will no doubt continue to take their decision in regard to reducing or increasing their stake in Indian equity markets. While RBI welcomes these flows it will also like to ensure that those FIIs who wish to reduce the investment can do so as easily as possible at prevailing market rates. As in the past, the authorized dealers acting on behalf of these FIIs are free to approach the RBI to procure foreign exchange at prevailing market rates depending on market conditions. RBI would either sell the foreign exchange directly or advice the concerned bank to buy it in the market.

For any further assistance the Task Force mentioned at para 2 may be contacted at any time.

Alpana Killawala
Chief General Manager

Availability of Liquidity for Settlement Banks

In light of the developments in the Stock exchanges, the RBI has been in touch with major settlement banks and both the major stock exchanges to ensure that the payment obligations on the exchanges are met smoothly. Banks can get in touch with the Reserve Bank for any liquidity assistance at Tel.No.2261-4228 (Smt. Shyamala Gopinath, Executive Director).

Alpana Killawala
Chief General Manager

References


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