Monetary Policy Transparency: Trends and Insights

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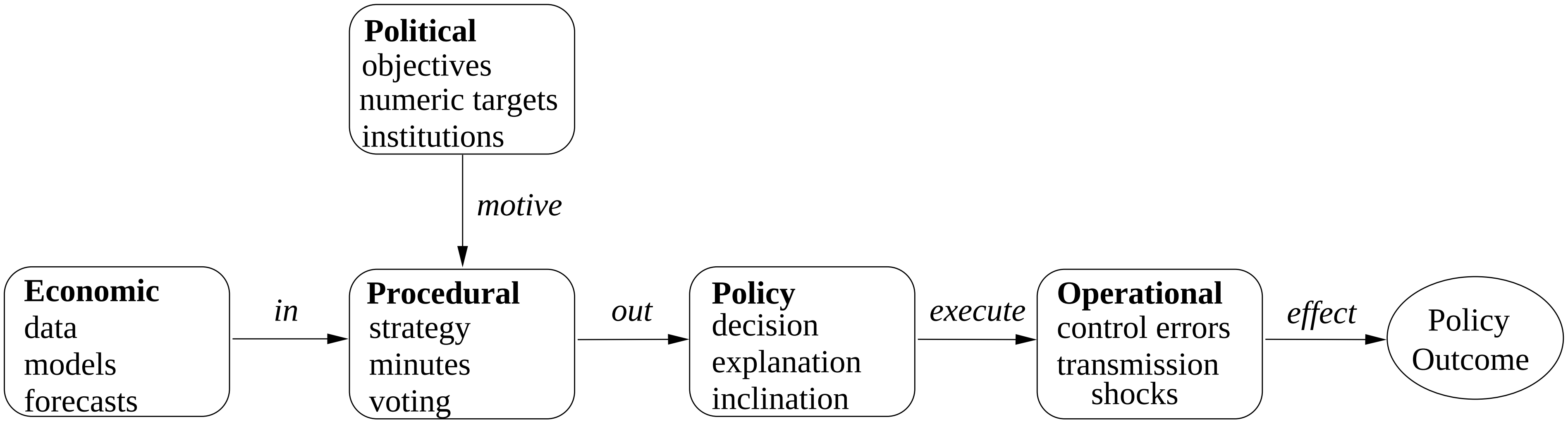
Conceptual Framework

Transparency refers to absence of asymmetric information.

It could pertain to any aspect of decision making process (Geraats 2002):



Effects of Transparency

In an economy with only an information asymmetry but no other market failures, transparency is welfare improving by the first fundamental welfare theorem.

$\star$ *Information effects*: direct, ex post effects of information disclosure (e.g. reduction of uncertainty)

$\star$ *Incentive effects*: indirect, ex ante structural changes in economic behavior resulting from different information structure (e.g. stronger reputation building)

Example: Disclosure financial health of banks could induce more prudent behavior ex ante, but trigger bank run ex post.

Monetary Policy Transparency – Theory

Information effects (Geraats 2007):
+ Publication of inflation target beneficial because it allows alignment of private sector expectations.
– Publication of output target and supply shock detrimental as it hampers inflation and output stabilization.

Incentive effects:
+ Publication of central bank forecasts makes policy action more accurate signal of central bank's intentions, quickly exposing any inflationary policy and thereby exerting discipline on central bank (Geraats 2005)
– Noisy public information could induce greater economic volatility as financial markets focus on it to coordinate their actions (Morris and Shin 2002)

Measuring Transparency

Approaches to measuring transparency:

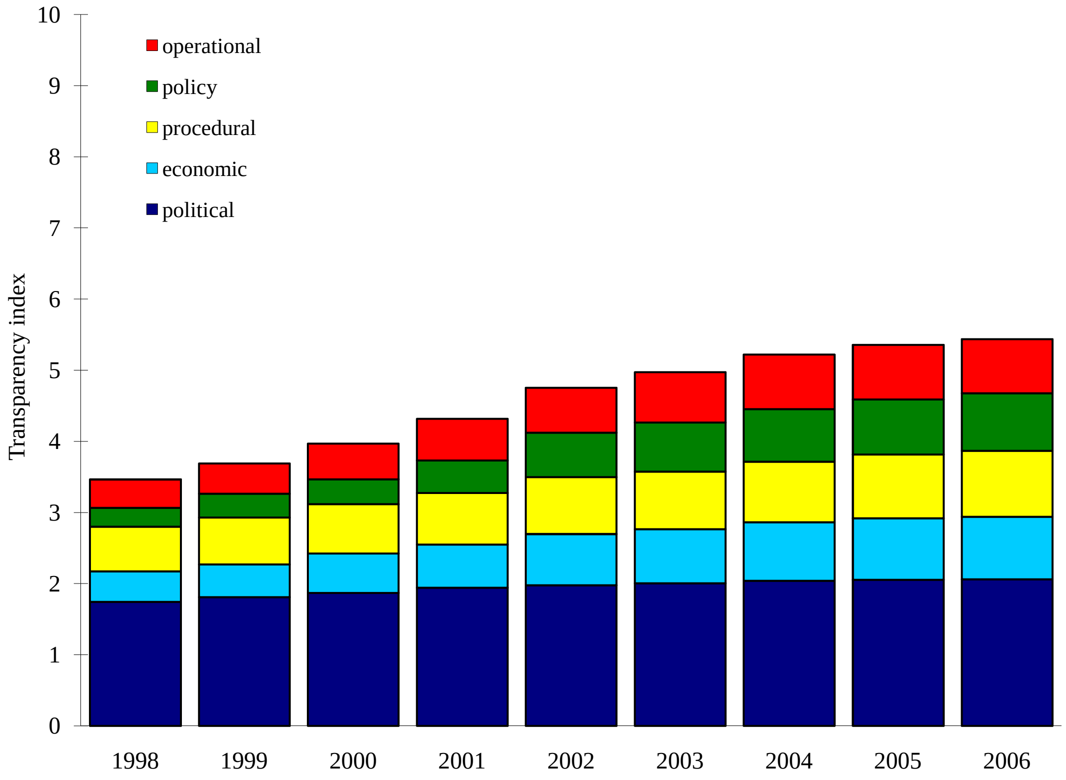
• Financial market reactions (Blinder, Ehrmann, Fratzscher et al 2008)

• Disclosure of information pertinent to monetary policymaking (Eijffinger and Geraats 2006; Dincer and Eichengreen 2007 & 2009)

Transparency index by Eijffinger and Geraats (2006) capturing five aspects
compiled by Dincer and Eichengreen (2009)
for 100 central banks from 1998 to 2006.

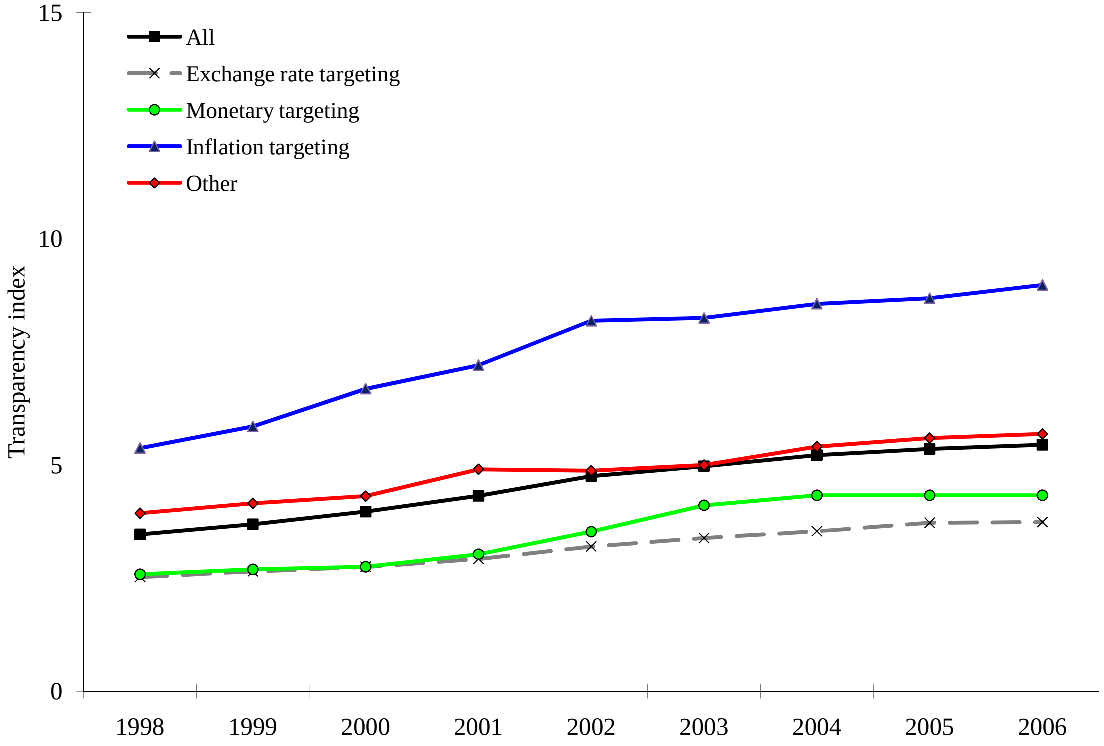
Monetary Policy Transparency Trends

Significant increase in all transparency aspects, especially policy and economic transparency.



Transparency Across Monetary Policy Frameworks

Significant increase in transparency for all frameworks,
but degree and type of information disclosure differ significantly.



Trends in Information Disclosure

Information disclosure	1998	2006	Change
Political: Quantification primary objective	43	62	19^{***}
Economic: Numerical macroeconomic forecasts	18	56	38^{***}
Procedural: Minutes	6	16	10^{***}
Policy: Policy adjustment	17	53	36^{***}
Operational: Transmission disturbances	20	46	26^{***}
Observations	98	98	

Asterisks indicate change significant at * 10%, ** 5% and *** 1%.

Institutional and Macroeconomic Environment

Stylized facts

• Central bank independence:
generally no strong correlation with transparency (except political).

• GDP per capita:
significant positive correlation with (economic) transparency.

• Initial inflation: significant positive correlation with subsequent increase in (political and operational) transparency

• Subsequent inflation: significant negative correlation with (all aspects of) transparency (excl FX targeters)

Conclusion

In general, transparency has information and incentive effects.

Significant increase in monetary policy transparency during last decade,
especially for policy and economic transparency,
and across monetary policy frameworks,
but with significant differences in information disclosure.

Regarding institutional and macroeconomic environment,
transparency largely unrelated to central bank independence,
but positively related to initial inflation and economic development,
and negatively related to subsequent inflation.

Monetary policy transparency largely appears to have been beneficial.