

Transparency of Monetary Policy in the Post-Crisis World

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Post-Crisis Challenges for Central Banks

Greater importance of financial stability issues.

Monetary policymaking further complicated by:

- Use of unconventional measures, such as large liquidity operations and LSAPs.
- Heightened uncertainty about economy, including 'output gap' and 'natural rate'.

Using central bank communications as monetary policy tool, especially through forward policy guidance.

Financial Stability Concerns

Financial crisis showed: Price stability \nRightarrow Financial stability

Macroprudential policy tools needed to achieve financial stability objectives (Tinbergen rule).

But without tried and tested institutional framework and macroprudential tools, financial stability concerns may affect monetary policymaking ('leaning against wind').

Example: Swedish Riksbank

Unconventional Measures and Monetary Policy Stance

Use of unconventional measures in response to financial crisis:

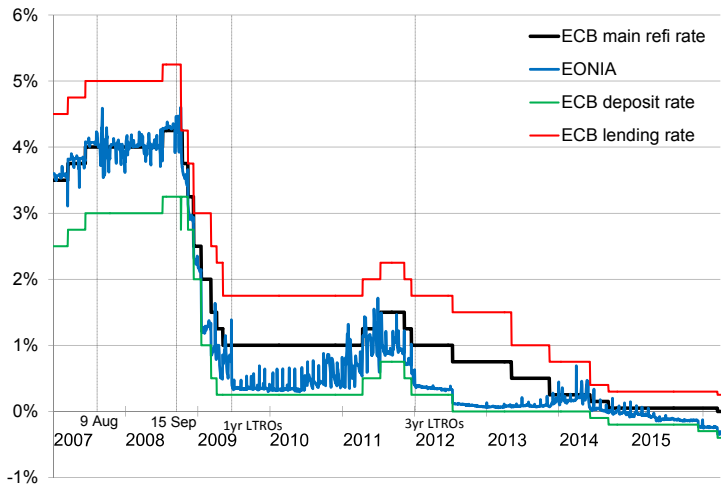
- + Large liquidity operations
could affect de facto monetary policy stance.

Example: ECB's longer-term refinancing operations (LTROs) with full allotment have reduced EONIA below main refi rate.

- + Large scale asset purchases (LSAPs)
make monetary policy stance multi-dimensional.

LSAPs usually announced in advance, speeding up effects.

Inaccuracy of ECB's Main Monetary Policy Signal



Notes: EONIA and ECB main refinancing rate, deposit rate and lending rate, 02-01-2007 - 01-04-2016.
Source: ECB

Forward Guidance

Forward policy guidance: communication of likely timing, direction or pace of future monetary policy moves.

Forms of forward guidance:

- ▶ Qualitative: code words [Fed, BoE, ECB] → ambiguous
(e.g. policy rate low for 'extended period'; raising rate at 'measured' pace)
- ▶ Quantitative:
 - + time-dependent [BoC, Fed; RBNZ, NB] → clear
(e.g. calendar-based; projected policy path)
 - + state-contingent [BoJ; Fed, BoE] → flexible
(e.g. threshold for inflation or unemployment rate)
 - ★ combining both [Riksbank]
(e.g. projected policy path with scenario analysis)

Illustrations of Power Forward Guidance

- Fed move [8/2011] from qualitative 'extended period' to calendar-based 'mid-2013' guidance reduced long-term Treasury yields by over 20bp.
- ECB announcement to 'do whatever it takes' [7/2012] and Outright Monetary Transactions (OMT) program [9/2012] have reduced euro area periphery sovereign debt yields so much that OMT still unused!

→ Forward guidance can be very powerful policy tool!

Transparency Taken Too Far?

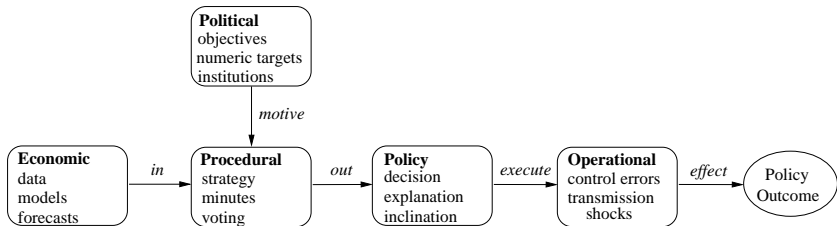
Distorting policymaking for sake of transparency undesirable.

- Postponing policy decision to be more predictable and avoid adverse market reactions.
- Prolonging policymaking process to publish minutes just-in-time together with policy announcement.

Example: Bank of England

Monetary Policy Transparency Index

Builds on Eijffinger-Geraats (2006) index
capturing 5 aspects of monetary policymaking:



Revised and updated for post-crisis world,
with greater granularity for procedural and policy transparency.

Compilation of new transparency scores for over 100 central banks in progress..

Conclusions

Monetary policymaking has become more challenging and transparency of monetary policy even more important in post-crisis world.

Financial stability concerns, unconventional measures and heightened uncertainty add complications.

However, central bank communications can provide powerful policy tool to help manage expectations and improve effectiveness of monetary policy.