Central Bank Communications : Some Random Thoughts[1]

Ms. Wanda Tseng, Mr. Ariyoshi, distinguished fellow central bankers and friends,

At the outset, I would like to extend a hearty welcome to all our guests to India. I hope you will find the weather outside as well as the intellectual stimulation in the seminar pleasant and productive. I am thankful to the organisers for inviting me to participate in the seminar. The subject is close to our head and heart and we, in the RBI, had organized a SAARCFIN sponsored seminar last year on this subject, and we learnt a lot from each others' experience in South Asia. Today's seminar is different, and may perhaps prove to be specially rewarding for several reasons: it covers a wider range of central banks, and has the benefit of participation by multi-lateral institution as well as the media representation, in addition to a private sector bank. The organisers need to be complimented on an excellent structuring of the seminar in terms of issues, classification and participation. I find the key questions for consideration listed in the programme very pertinent , and so, perhaps it is ideal for the keynote address to outline some random thoughts on the questions, based on our experience in the Reserve Bank of India (RBI).

In the past, central banking was shrouded in secrecy with some 'mystique' surrounding it. In the recent years, however, there has been greater visibility, transparency and communication. What are the reasons? First, increased independence of central banks warranting publicly accountable conduct; second, adoption of inflation-targeting – whether through a legal sanction or otherwise; third, a mandate to the central banks, either explicit or implicit, for maintaining financial stability in a world where the financial markets and their expectation matter. It is interesting to note that even in the UK, where there is a Financial Services Authority, it is the Bank of England which publishes the Financial Stability Report, periodically.

What are the theoretical perspectives in this regard? The academic and policy literature recognises the role of communication for the effectiveness of

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[1] Keynote address delivered by Dr. Y. V. Reddy, Governor, Reserve Bank of India at the Regional Seminar on Central Bank Communications sponsored by the International Monetary Fund, held at Hotel Taj Land End, Mumbai on January 23, 2006

monetary policy, and has broadly focused on four aspects of policy, namely, efficiency, time-consistency, optimality of communications, and institutional-cum-decision making processes. Efficiency issues centre around quality, elements of noise, formation of expectations, and implementation lags. The time-consistency issues relate to the conditions for substitutability between communications and policy actions, and choices between effectiveness of unanticipated policies relative to elimination of uncertainty in private decision making. The optimality issues address the aspects of dangers of disseminating information which could result in crowding out of the formulation of independent beliefs by the private sector – which is critical to well-functioning markets. The institutional and decision-making processes of monetary policy refer to the recent trends towards autonomous group-decision making, like the Monetary Policy Committee of the UK; the composition of the groups, the periodicity of their meetings, the attributability of opinions, the transparency, etc. It should, therefore, be clear that even on the limited issue of communication policy in regard to monetary policy, the literature provides a framework but the practices tend to be diverse amongst countries. There is no universally valid international benchmark on the subject but the framework, which is still evolving, is useful as a reference point for exchange of information amongst different countries that this Regional Seminar seeks to promote. While the framework for a country is useful, it is the judgment within the framework that really matters. In India, we are proceeding gradually to a more open and participative process monetary policy formulation, which will be covered by my colleagues later in the seminar.

The growing importance of communications by central banks is on account of their responsibility for maintaining financial stability – which includes but goes beyond the conduct of monetary policy. There is an assumption that well-informed market participants would enable, if not assure, an improved functioning of the markets, and a central bank is in the best position to provide such useful information. However, whether providing information would result in shaping and managing expectations, and if so, whether it is desirable, are difficult issues. For example, The US Federal Reserve, since 1994, appears to have been providing forward guidance, while the European Central Bank appears to be in the mould of keeping the markets informed rather than guiding it. We, in India, have taken a middle path of sharing our analysis in addition to information, but in no way guiding the market participants. However, in doing so, we have the benefit of the process of two-way communication, of information as well as perceptions, between the market participants and the RBI. The two-way process is enabled by formal structured meetings with industry associations, through standing advisory committees, and informal / *ad hoc* committees, technical reports, working groups, etc.

At this stage, I must share with you one concern about the credibility bonus earned by the effective communications policy. Is it possible that such “hands on” and “very successful” communications by the central banks in the world to maintain financial stability have resulted in under-pricing of risks by the private sector, or in distinct lowering of aversion to financial risks? Is it possible that this credibility bonus is partly responsible for the upward movement of the housing and equity prices becoming a global phenomenon?

The issue of financial stability is of great significance and enormous complexity for central bankers in the Emerging Market Economies (EMEs). The EMEs vary considerably in their fiscal, current account, openness to external sector, and dependence on oil-earnings or oil-imports. Yet, the analysts in the financial markets often treat them as a group, presumably because the EMEs are perceived to be to be high-risk and high-reward destination for financial capital. That characteristic lends them to vulnerability in capital flows, sometimes for reasons other than economic fundamentals in the country concerned. As the title implies, the EMEs are emerging from one state to another, namely, from less market orientation to greater market orientation, and are thus, in a state of transition. The central banks in the EMEs, in their pursuit of financial stability, have two additional challenges. First, to mange the transition in their own economies, which has socio-economic as well as political dimensions; second, to keep a watch on the sentiment of foreign capital flows – which could change for reasons other than domestic. While for a particular foreign investor it may be a small portfolio shift from an EME to an industrialised country, it may be one of large magnitude for the EME concerned. The challenges for communication policy are considerably more complex for the central banks in the EMEs for another reason, namely, the asymmetrical response of the financial markets to the developments in the EMEs. For instance, the market reaction to an increase of, say, US dollar five billion in the forex reserves of an EME would be comparatively subdued vis-à-vis the response to a decline in reserves by a like amount.

In India, several measures, monetary as well as administrative, were undertaken to meet the threats to financial stability while complementary or parallel recourse was taken to communications. Some illustrations are: a speech in Goa in August 1997 to "talk down the rupee"; reassuring statements on market developments in the context of Asian crisis combined with a package of measures, in tranches in 1997 and 1998; pre-emptive measures in mid-1998 in the context of crisis in Russia; reassuring statements issued in the context of Kargil war in 1999; a combination of liquidity injection, reassuring statements along with measures in the context of the 9/11; a combination of actions and measures at the time of sharp downward movement of Indian stock markets on May 17, 2004 coinciding with the political transition at the national level; and more recently, to explain the impact of redemption of the India Millennium Deposits to the extent of US dollar seven billion. There are several other instances when there were thoughtful inactions. For instance, RBI decided not to take any measure or issue a statement when US imposed sanctions on India. In brief, we have open market operations, open mouth operations, and open only eyes and ears operations in regard to threats to financial stability.

Many central banks perform a multitude of functions and their responsibilities are seldom restricted to monetary policy and financial stability. Hence, communication policies and strategies have to be tailored to meet the needs of specific function to be performed on the one hand, and on the other, having an overall consistent or common policy framework within which the central bank functions. For instance, the RBI has the responsibility to develop and regulate money, forex and government securities markets, with some dilemmas to be resolved when RBI is both a developer and a regulator. It is also a debt manger to the Central and the State governments. Thus, the communication policies, strategies and contents while dealing with the market intermediaries are different from those adopted, in dealing with, say, State governments, for whom RBI is also a banker and a debt manager. The RBI is also a regulator, specially of banks, with distinct interests being served, namely, depositors, consumers in general, systemic efficiency as well as stability, and the banks themselves whose health is critical to the financial sector. Communication policies are, therefore, tailored separately for each category of stakeholders. Finally, several services are rendered by a central bank, specially in matters relating to currency and coins, payments system, credit information, and overall, grievance redressals.

Communication, indeed, is not neutral to the target audience. For a central bank's communication, it is varied and includes general public, financial market participants, media persons, entities regulated by the central bank, academics, financial markets analysts, rating agencies, international or multi-lateral bodies, etc. Let me illustrate with a communication initiative that RBI took recently. The Ombudsman Scheme for banks was revised recently and hence, the objective was to inform the widest section of our population. A Press Release might not have fully served the purpose. So, a decision was taken to issue an advertisement – for which the content was indeed common but the languages differed. It was interesting to notice that while 17 leading English newspapers have a combined circulation of 6.3 million and readership of 17.9 million, the 15 leading Hindi newspapers have a larger circulation at 8.1 million and a far larger readership at 87.0 million – that is, almost five times larger. In fact, 54 leading non-English newspapers in India have a circulation of 21.4 million and a readership of 197.2 million. This has been our target coverage for the latest effort in communication, recognizing that most of the targeted 200 million middle-class in India reads vernacular newspapers.

There are several dilemmas faced by central banks while designing an appropriate communications policy. What should be communicated and to what degree of disaggregation, are one set of issues. The second set relates to: at what stage of evolution of internal thinking and debate should there be dissemination. The third set relates to the timing of communication with reference to its market impact. The fourth relates to the quality of information and the possible ways in which it could be perceived. Thus, alleged incoherence or an element of ambiguity at times on the part of central bankers in explaining policies is as much a reflection of the complexity of the issues as it is of the differing perceptions of a variety of audiences to which the communication is addressed.

In assessing the contribution of the media to the financial sector as a public good, I would distinguish among at least four types of effects. The first type may be characterised as the ‘news effect’, which would normally reflect factual or formal positions or events. In a sense, the media’s reporting would be faithful and non-controversial. A second type can be identified as ‘rumour effect’, and often rumours have a destabilising effect and in some cases have the potential to degenerate into self-perpetuating or self-fulfilling events. The rumour effect often results in unintended losses or gains and people may suspect that there is some vested interest behind such rumours. Needless to say, the media’s role will, on the whole, tend to be negative in this channel. The third type is marked by the ‘survey effect’. It is not uncommon for the media to undertake opinion polls or surveys and these could have methodological and other problems in terms of reflecting the true picture. These surveys have a tendency to influence the perception of markets and sometimes the general public. In such a case, the contribution of the media would depend on scientific methodology adopted, transparency of assumptions, and objectivity in presentation of the results. Adequate care is a pre-condition to ensure a positive effect through this channel. The fourth is the ‘interpretation effect’, where media tries to interpret the stand taken by policy makers or markets or corporates. The interpretation effect may be positive or negative depending on professional skills as well as commitment to objectives. Responsibility and accountability would be key to ensure positive effect through this channel. In brief, it is my submission that the media’s responsibilities are not confined to its shareholders or to its subscribers, but extend to the larger segment of the public. In this sense, the challenges and dilemmas before the media are perhaps no less than those before the central banks.

It is also fair and appropriate to recognize that media itself faces several dilemmas. For example, there are pressures to be the first to report – a race to be the number one. There are incentives to be distinctive. They have several stakeholders to cater to. They may or may not have ideological predilections. But as far as the RBI is concerned, the media has been very fair and I find it a pleasure, inspiration and education to interact with the media. It is great fun to share my confusions and dilemmas with all types of media – which are amongst the best and the brightest in India.

Before concluding, it is essential to appreciate that communication policy is not merely about explaining or getting a feedback on policy, but may include elements of influencing the policy direction itself. A central bank does this through several channels, including research publications and speeches. As Dr. I. G. Patel, an eminent statesman-scholar and one of my distinguished predecessors said in 2004:

> *"Communication is not just about transparency. It is also about education, guidance and steering things in the right direction. In this, the central bank can be an honest broker between the government and the public and even the parliament."*

Perhaps, it is possible to illustrate, with a bit of lack of modesty, how this has been done, with a quote from Mr. S. S. Tarapore[2], my predecessor as Deputy Governor:

> *"While I have been assigned the task of talking about gold and capital account convertibility, before doing so I would, for a moment, like to refer to some developments prior to the setting up of the committee on Capital Account Convertibility (CAC). When the definitive history of India's policy on gold is written up, the speech by Dr. Y. V. Reddy, Deputy Governor, Reserve bank of India, at the World Gold Council Conference on 28 November 1996 will stand out as a watershed as it is perhaps the only speech by a senior Indian official which squarely takes on issues on gold policy and it will be appropriately recorded as a forerunner of major policy change. It is by raising pertinent issues that Dr. Reddy has paved the way for the committee to come up with specific recommendations on India's policy on gold."*

An interesting question that arises is about the role of the Governor of a central bank when important policy issues impinging on central banking are involved. A quote from late Dr. I. G. Patel would perhaps be the best guide:

> *"But the point is, when such vital questions arise, the Governor can not*

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[2] His address at Gold banking Seminar of World Gold Council, New Delhi, 2 August, 1997.

> *just be inactive. He is a public servant with loyalty to the country and the constitution – not just to a government in transit. And yet, he can not behave as if every issue is of great import. He has to choose his ground and be discreet above all. Without offending the Government, he can start a debate and steer the argument in a certain direction. His ultimate defence is democracy and the tradition of free debate."*

Let me again thank you all for provoking me think about the subject.

I wish the seminar all success and we, in the RBI, look forward to benefiting from the deliberations.