Communicating Monetary Policy[1]

Monetary policy announcements are associated with frissons of animated speculation rippling through public discourse. Projections are revised, and the balance of risks are re-tilted. Shadow monetary policy committees take positions in print and in sound bytes. Curve fitting the central bank commences – is it behind the curve? – and accordingly, bird-like postures are conjured to characterise its angle of repose. Markets get poised to reprice, and financial institutions reassess interest margins. Depositors and businesses exert conflicting pulls on public opinion. Questions rent the air on the likelihood of rate movements, by how much, and on shifts in stance.

Underneath the multiple shocks buffeting the global economy, the conduct of monetary policy is undergoing a silent transformation worldwide. In the wake of the pandemic, several central banks have undertaken strategic reviews of their policy frameworks in tacit confirmation of this quiet revolution[2]. These reviews have also shed light on the vexed issue of communicating monetary policy which is the theme of my address.

II. The Evolution of Monetary Policy Communication

The history of changes in monetary policy architecture and implementation is best captured in the story of the evolution of the communication of monetary policy over the years. Until the early 1990s, secrecy was the byword in the conduct of monetary policy. Central banks used to be shrouded in mystery and they believed that they should be. The conventional wisdom was that monetary policy makers should say as little as possible and say it cryptically. The personal motto of Montagu Norman, the longest serving Governor of the Bank of England (1920-44) has been described pithily:

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[1] Opening remarks by Michael Debabrata Patra, Deputy Governor, Reserve Bank of India at the "High-Level Policy Conference of Central Banks in the Global South" organised by the Reserve Bank of India as a part of commemoration of its 90th year on November 21, 2024 at Mumbai, India. Valuable comments received from Indranil Bhattacharya, Binod B Bhoi, G.V.Nadhanael, and Subhadhra Sankaran are gratefully acknowledged.

[2] Coined by Alan Blinder, former Vice Chairman of the Board of Governors of the US Federal Reserve and currently Gordon S. Rentschler Memorial Professor of Economics and Public Affairs at Princeton University, USA.

"Never explain, never excuse"[3]. Monetary policy was regarded as an esoteric art with access to it and its proper execution confined to the initiated elite. It was characterised by an inherent impossibility to articulate its insights in explicit and intelligible words and sentences[4]. In fact, after the Bank of England's rebirth twice in the past century – in 1992 as an inflation targeter, and in 1997 as an independent central bank – a member of its monetary policy committee (2003-06) remembered that inscrutable era when "the stated objective of the Bank of England's press officer was to keep the Bank out of the press and the press out of the Bank."[5]

This monetary mystique was dispelled in February 1994 when the US Federal Open Markets Committee (FOMC) first started announcing its decision on the target for the federal funds rate. Yet, it was not till August 1997 that the Fed publicly acknowledged that monetary policy is formulated in terms of a target for the federal funds rate and put a number to it. Even so, monetary policy communication was characterised by 'constructive ambiguity'[6] or what has been described as 'mumbling with great incoherence'[7]. Alan Greenspan, then Chair and high priest of this Fedspeak, turned the commitment to opacity into an art form. He perfected a style of speaking regularly while communicating little. On several occasions, he left his audience less informed than before he spoke. There was an underlying rationale to this opaqueness. Greenspan believed that a language of purposeful obfuscation is much better than not responding; or saying, "no comments"; or "I won't answer". The theoretical premise was that the behaviour of rational economic agents, who use all available information to anticipate the future, including the course of monetary policy, could only be influenced through policy surprises.

Paradoxically, it was Alan Greenspan who started the move towards greater transparency and openness in communicating monetary policy. By the early 2000s, he

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[3] B.S. Bernanke (2015), Federal Reserve Communications, Speech delivered at the Cato Institute 25th Annual Monetary Conference, Washington, D., November 14.

[4] K. Brunner, (1981), The art of central banking, University of Rochester Center for Research in Government Policy and Business Working paper GPB 81-6.

[5] F. Capie (2010), The Bank of England 1950s to 1979, Cambridge University Press.

[6] G. E. Corrigan (1990), Testimony to Senate Banking, Housing and Urban Affairs Committee, May 02.

[7] A. Greenspan (1987), Speaking to a Subcommittee of the US Congress, November-December 1987.

was explicitly managing expectations by stating that “the Fed would keep the Federal funds rate low for a considerable period”. This trend was also reflecting broader societal changes. Considerations relating to democratic accountability took precedence over constructive ambiguity. As a public institution operating on delegated authority, the central bank must be fully accountable to the elected representatives of the people. In fact, transparency came to be regarded as an implied corollary of central bank independence. The great transformation came in the wake of the global financial crisis (GFC). With interest rates at the so-called zero lower bound and balance sheets bloated by unconventional ultra-accommodation, communication got elevated to the status of a monetary policy instrument. Forward guidance was actively used by central banks to go beyond the short-term money market rate and directly influence longer-term rates. Terms like ‘low for longer’ and ‘to do what it takes’ started populating the language of central banks. Explanation, Engagement and Education had become the three Es of communication[8] when the pandemic struck. The lessons of the GFC came in handy during the pandemic when central banks became the first line of defence in an environment of high uncertainty. People looked to central banks for support as well as the reassurance that they would do all they could to prevent loss of livelihood and restore stability in financial markets and institutions. Monetary policy communication performed the role of an anchor in an ocean of fear and vast unknowns.

When inflation checked in from the second half of 2021 and rose to levels not seen since the 1970s and early 1980s, central banks reacted albeit belatedly with large and consecutive interest rate increases. Suddenly, the lessons of the GFC were no longer relevant as terminal rates in this tightening phase could not be communicated in view of the stubbornness of the inflation episode. Testifying before the Senate Banking Committee, when Chairman Jerome Powell was charged with ‘gambling with people’s lives’; he responded: “will working people be better off if we just walk away from our jobs and inflation rebounds?”[9] Furthermore, central bank authorities began to

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[8] A. Haldane, A. Macaulay, and M. McMahon, (2020): The 3 E’s of central bank communication with the public, Staff Working Paper No. 847, Bank of England, January.

[9] Testimony before a U.S. Senate Banking, Housing, and Urban Affairs Committee hearing on "The Semi-annual Monetary Policy Report to the Congress" at Capitol Hill in Washington DC on March 7, 2023.

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speak with increasing fervour and frequency on the need to remain steadfastly anti-inflationary until targets were sighted. Forward guidance stirred up bouts of turmoil in financial markets, and spillovers to emerging markets. In March 2023, financial stress felled banks in some jurisdictions, unwinding of carry trade was triggered in August 2024 and sell offs on recession fears routed markets worldwide in September 2024. Monetary policy communication entered a new phase of its evolution as it encountered lower signal-to-noise ratios and the 'cacophony problem' – too many disparate voices that confuse rather than enlighten the public.

Today, the story of monetary policy communication has come full circle. Following its strategic review, the Governing Council of the European Central Bank "agreed to modernise its monetary policy communication….to make listening a regular feature of its communication"[10]. An important pillar of the US Fed's review of monetary policy strategies, tools and communication is that the 'Fed listens'[11]. It is noteworthy that the RBI has been in listening mode for more than a decade, but more on that later. It is now recognized that communication is a two-way street. It is not just about talking. It is also about listening in order to learn to steer the economy. The louder the central bank talks in these times, the more likely it is to hear its own echo[12].

This guided tour through the historical evolution of monetary policy communication yields valuable insights: (a) the principles underlying communication are not cast in stone – communication has to be alive to the state of the economy, the state of the business cycle and societal influences; (b) there are limits to transparency, and trade-offs exist between desirability and feasibility; (c) feedback mechanisms and performance reviews must be built into communication so that central banks listen to the public rather than only speak. In the rest of my address, I will explore how the RBI's monetary policy communication fares against these lessons.

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[10] ECB Strategy Review (2021), Clear, consistent and engaging: ECB monetary policy communication in a changing world, European Central Bank Occasional Paper Series No 274, December (Revised).

[11] Board of Governors of the Federal Reserve System (2020). Fed Listens: Perspectives from the Public. Washington: Board of Governors, June.

[12] H.S. Shin (2017), Can central banks talk too much? Speech at the ECB conference on "Communications challenges for policy effectiveness, accountability and reputation" Frankfurt, November 14.

III. How the RBI Communicates Monetary Policy

At the outset, it is fair to say that the RBI's monetary policy communication strategy is constantly evolving as it balances the diverse and strident demands of country-specific stakeholders with global best practices. Furthermore, there are layers in its communication strategy which are shaped and nuanced by when, what, who, how and how much to communicate.

Information on the objectives, policy framework, decision making, instruments and processes designed for the general public is updated and put out on the RBI's website, with links to key policy rates, statements, transcripts of press conferences and minutes of monetary policy committee meetings. Assessments based on a text-mining approach indicate that the degree of transparency has been progressively enhanced, especially after the adoption of the flexible inflation targeting (FIT) framework[13]. Coincident survey-based information adjusted for biases such as backward-looking price assessment, overall sentiments about the economy and the impact of prices of salient items on overall perceptions shows that inflation expectations have also become anchored, and they do track realised inflation[14]. This suggests that monetary policy awareness among the lay public is increasing.

Since the adoption of FIT in 2016, the RBI's monetary policy communication practices have largely mirrored global best practices in terms of publishing the analysis of evolving economic conditions, including outlooks for growth and inflation and the associated risks, and explaining the rationales for policy decisions, both in policy statements and through press conferences, which is followed by the release of the MPC minutes one fortnight after the policy announcement. Unlike some advanced economy central banks, however, the RBI has generally refrained from providing explicit forward guidance on the policy rate, although it has provided both time- and state-contingent forward guidance during the COVID-19 pandemic. During the policy tightening cycle amidst heightened global uncertainty and overlapping shocks, the RBI

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[13] Samanta, G.P., and Shweta Kumari (2021) Monetary Policy and Anchoring of Inflation Expectations, RBI Working Paper 03/2021.

[14] Muduli, S., G.V. Nadhanael and S. Pattanaik (2022), Assessing Inflation Expectations Adjusting for Households' Biases, RBI Bulletin, December.

was of the view that forward guidance itself could be a source of policy uncertainty undermining policy credibility. Accordingly, it refrained from forward guidance in the policy tightening cycle. Nonetheless, the RBI has emphasised on clarity in communication, while maintaining a balance between both high and low frequency communication of monetary policy.

In recent years, significant emphasis has also been placed on the complementary role of engagement and education in furthering central bank communication. Pre-policy consultations are held with various stakeholders – analysts; economists; academics; banks; industry bodies; and domain experts – followed by post-policy interactions with the media while reaching out to the general public. The article on the "State of the Economy" in the RBI Bulletin every month seeks to provide an updated synoptic view of the economy to the public. Speeches and interviews in various forums by Governor and Deputy Governors seek to sensitise, engage and educate the public about the policy decisions, their rationale and policy challenges. At the same time, central banking research has increasingly focussed on contemporary macroeconomic and policy issues. For instance, the theme-based Report on Currency and Finance (RCF) 2020-21, which dealt with the theme "Reviewing the Monetary Policy Framework" was released before the renewal of the inflation target for the second five-year term; the 2021-22 Report adopted "Revive and Reconstruct" as its theme in view of the devastating impact of the COVID-19 pandemic on the economy; the 2022-23 Report dealt with climate change issues and adopted "Towards a Greener Cleaner India" as its theme to enrich public policy discourse on the emerging subject; and the 2023-24 Report focused on India's digital revolution. On the educational front, the RBI has been conducting competitions for educational institutes, sponsoring short period internships for students and using various electronic and social media platforms to educate people on the role and responsibilities of the RBI so as to build trust, and gain confidence of the public.

The RBI's communication strategy has been appreciated in recent years. For example, the Bank for International Settlements (BIS) in its 2018 Annual Report noted "…the Reserve Bank of India issues short and simplified press releases for an audience with limited financial literacy. Establishing links with the media, such as through background briefings, is another common tool." Moreover, empirical evidence suggests forward guidance likely played a key role in moderating uncertainty and supporting asset prices during the initial waves of the COVID-19 pandemic, underscoring an important role for monetary policy communication in guiding market expectations in India about the monetary policy stance, including the likely path of policy interest rates.[15] For example, the RBI's decision on October 9, 2020 and the Governor's statement on forward guidance was specific about the duration of the RBI's accommodative stance, contributing to a decline in 10-year rates on the same day.

IV. Conclusion

While the utility of forward guidance at very low policy rates is unambiguously proven, its efficacy at higher rates is questionable. This is consistent with the asymmetric nature of the monetary policy cycle – the way down has a lower bound, but the way up is technically unconstrained by any upper bound. Under heightened uncertainty, discretion in forward guidance has increasingly gained legitimacy among major central banks. Empirical evidence in the Indian context suggests that forward guidance in a policy tightening cycle loses steam as the policy rate increases beyond a threshold.[16]

Summing up, the optimal level of communication remains the gold standard for all central bankers – too much can create a "signal extraction problem" while too little can keep the markets guessing. As a former Fed Chairman succinctly noted "Monetary policy may be 98% talk and only 2% action but cost of sending the wrong message can be high.[17] In this regard, both the monetary policy framework and its communication need to reflect the inherent uncertainty in policymaking. As noted earlier, forward guidance in a tightening cycle is constrained but admitting this through communication may undo the intent of policy. In a similar vein, while monetary policy needs to manage inflation expectations, micromanaging them may be

[15] F. Ahmed, M. Binici and J. Turunen (2022): Monetary Policy Communication and Financial Markets in India, IMF Working Paper WP/22/209, October.

[16] M. D. Patra, I. Bhattacharyya and J. John (2023), When Circumspection is the Better Part of Communication, RBI Bulletin, July 17.

[17] B.S. Bernanke (2015), Inaugurating a new blog, The Brookings Institution, Economic Studies.

counterproductive.[18] In terms of targeting the audience, central banks are still learning how best to communicate with the wider public. It is said that communication is the bridge between confusion and clarity. Central banks must engage in constantly refining and upgrading this "soft skill" to make it effective. As John Powell, the famous composer of film scores, said "Communication works best for those who work at it". Thank you!

[18] M. McMahon (2024), Lessons for Monetary Policy Communication: Communication, Getting Through and Expectation Formation, Presentation made at the Reserve Bank of Australia Annual Conference, October.