Central Bank Transparency for Monetary and Financial Stability

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Introduction

- Key role of transparency for both monetary and financial stability.
- Monetary and financial stability: a threat to one can be a threat to the other.
- Transparency and communication: closely linked, but separate.

Introduction (2)

Will discuss:

- Transparency and communication for monetary stability.
- Transparency and communication for financial stability.
- Transparency and communication in monetary or financial crisis.
- Afterthoughts and conclusion.

Monetary Stability

- General recognition that monetary policy in a market environment is much facilitated if there is credibility in what the authorities are doing (e.g. labor contracts are negotiated on the basis that the authorities' inflation target will be achieved).
- Need for credibility becomes particularly important with monetary regimes that are forward looking and pre-emptive—e.g. with inflation targets, which cannot be directly observed.
- Achieving credibility is facilitated by clear exposition of what is the target, and when and how decisions are made, and demonstration that decisions are indeed made with regard to the announced target.

Monetary Stability (2)

- Independence of central banks—which itself is shown to enhance ability to achieve monetary stability—requires increased degree of accountability.
- Accountability enhanced by transparency in policy operations, including explaining what one is doing (governor's appearances before parliament).

Monetary Stability (3)

- In "new" environment, policy decisions are made at pre-specified times, with the decision clearly communicated to all interested parties simultaneously.
- Authorities seek to ensure that it is clearly understood what the signaling instruments are.
- Strategic approach adopted to monetary management; decline of fine tuning.
- Avoidance of "mixed messages," but refinement of heavily nuanced messages (debates over publication of minutes, and code of conduct for communications).
- Detailed analysis provided in central bank report.
- Policy makers provide clear summary explanations to the public.

Monetary Stability (4)

- Transparency and credibility particularly important at times of regime change, e.g. move from fixed to floating exchange rate, or entry into currency union.
- UK: heightened emphasis on transparency after exit from the European Exchange Rate Mechanism.
- EMU seeking to inherit Bundesbank credibility at outset.
- Communications emphasize continuity aspects, and—given that credibility takes time and visible implementation to achieve—seek to capitalize on credibility inherited from previous system.

Financial Stability

- Increasing recognition, particularly in light of financial crises of past years, of financial stability as critical concomitant to monetary stability.
- Concern that opening of economy increases vulnerability to financial crisis.
- "Macroprudential analysis" developing—new, and less mature than "macro" or "prudential"

Financial Stability (2)

- Managing financial stability in many ways reflecting developments in managing monetary stability
- Organizational: central banks introducing financial Stability Wings as counterpart to Monetary Wings.
- Recognition of interlinkages: financial stability incorporates more than just the banks; may include e.g. payments systems, insurance companies, microfinance.
- Transparency: financial stability reports; development of new indicators (financial soundness indicators); disclosure requirements on banks; harmonization of accounting practices.

Financial Stability (3)

- Transparency and communication issues more contentious regarding financial than monetary stability. Debate on extent of disclosure. At one extreme, even admitting working on financial stability issues may cause moral hazard, and admitting focusing on a particular institution may cause problems for that institution.
- Clearly, authorities may need some time to resolve a situation (e.g. find a buyer for a bank) before the situation becomes public.
- However, authorities may be “buying time,” which may be costly. Experience shows that avoidance of disclosure may lead to postponement of action, which increases ultimate costs of resolution.

Financial Stability: the Role of International Standards and Assessments

- While internal actions can certainly generate credibility, external reports can assist this process, especially where credibility is not established.
- Long tradition of rating agencies for sovereign issues and capital markets.
- After the Asian crisis, development of standards and codes covering aspects of economic and financial management: 12 standards and codes approved by IMF and World Bank boards.
- Widespread public discussions in many countries (including for instance India) on application of the standards and codes to the local environment.

Role of International Standards (2)

- Standards and codes intended for policy makers and, as importantly, for markets, to assist understanding of risks to financial stability.
- Aim is to provide information in a clearly understood way, following accepted “best practices:” important element of transparency, as well as means to provide framework for developmental agenda.
- While standards need to be applied differently in different environments, general consensus that one does not want “two tier standards” with weaker levels for developing countries.

Role of International Standards (3)

- Studies show markets consider data standard (SDDS) to be amongst the most useful.
- Most countries in region subscribe to SDDS.
- Huge improvement in data dissemination since the Asian crisis: SDDS focuses on timeliness and coverage of monetary, fiscal and macroeconomic data.
- Reserves template important element: ensures data provided in transparent format. Should avoid confusion during Asian crisis that impeded decision making by markets and policy makers.
- Concern that over-timeliness could reveal authorities' trading positions, and cause losses: reserves template thus mandates only monthly disclosure (frequency and timeliness) although many central banks provide more.

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Role of International Standards (4)

- Financial Sector Assessment Program (FSAP) as major tool of IMF/World Bank.
- Provides assessments of financial sector standards, as well as of the state of the various sectors.
- Draws on respective standard setting bodies (Basel Committee, IOSCO, CPSS, IAIS, FATF).
- Participation voluntary, and publication voluntary.
- Over 100 countries have requested FSAPs, but East Asian area lagging.
- No countries appeared perfect: identification of weaknesses seen as opportunity to redress.
- Markets not upset by identification of weaknesses: generally these were already known, and identification seen as positive sign that authorities were prepared to be transparent.

Role of International Standards (5)

- Financial stability likely to be enhanced by countries progressing toward observing international standards, inviting outside assessments of degree of observance of these standards, and communicating the results of these assessments.
- Credibility in seeking to achieve financial stability likely also to feed back on to enhancing credibility in achieving monetary stability (similarly, lack of credibility may also feed across).

Transparency and Communication in Monetary Crisis

- Monetary crisis may emerge due to inappropriate policies or exogenous factors, or a combination: exchange rate crisis the classic.
- Crisis likely to be worse if accompanied by loss of official credibility—e.g. if there is a "surprise" exhaustion of reserves, or sudden unexplained reversal of policy.

Monetary Crisis (2)

- Repeated protestations of no devaluation may make subsequent devaluation all the more shocking.
- Public measures needed to restore credibility: first step in practice often the dismissal of the minister/governor involved.
- Next step the enunciation of a complete program, supported by all surviving policy makers, to address the crisis.
- Credibility often enhanced by seeking outside endorsement and tie-in of new program, e.g. from the IMF.
- Announcement of intention to seek such program can have instant effect, e.g. UK in 1976.
- Danger of loss of credibility if promises are not delivered.

Transparency and Communication in Financial Crisis

- Financial crisis generally provoked by consequences of (fear of) bank illiquidity and insolvency.
- Likely to be period of questioning the credibility of official and private announcements.
- Loss of credibility likely to seriously exacerbate the crisis; may require lengthy process to reverse.

Financial Crisis (2)

- Authorities quickly need to develop an overall strategy and to be able to communicate it effectively: this should include a complete assessment of the situation, as well as policies with regard to those who are potential losers (depositors, creditors, owners).
- Policies need to be adopted quickly to ensure no plundering by those with privileged access (e.g. bank owners), so as to reduce risk of surge of public cost and of loss of public support for resolution plan.
- Announcements need to be informative, honest and timely—but not premature. Dangers of appearing to contradict oneself.
- Mere announcement may not have credibility: implementation needed for credibility.

Financial Crisis: the Case of Indonesia (1)

- October/November 1997: 16 banks closed; remedial measures announced for other banks.
- Initial positive impact, but subsequent complete loss of confidence.
- Loss of confidence partly because of policies: no blanket guarantee; reversals of some closures.
- Also gaps in communications: announcements were not complete, in part since central bank felt bound by pre-existing confidentiality agreements in the handling of some of the banks; also, rationale for which banks were closed was not explained. Apparently, privileges for well connected. Uncertainty over strategy.

Financial Crisis: Indonesia (2)

- January 1998. Collapse of first IMF program; subsequent announcement of blanket guarantee and establishment of IBRA.
- Television coverage: joint appearance of finance minister and central bank governor; pictures of banknotes being delivered; appointment of well-respected official as first head of IBRA.
- Initial reassurance to markets; big bounce back of exchange rate.

Financial Crisis: Indonesia (3)

- February 1998: IBRA took control of 50 banks, putting its officials into the banks.
- Transparent criteria adopted; comprehensive approach to banking system.
- President accepted entire proposals, but insisted on no publicity.
- No public impact from interventions; officials had no leverage within banks; appearance that IBRA was inactive.
- Further loss of confidence due to ad hoc announcements from president; dismissal of first head of IBRA; bank runs intensified.

Financial crisis: Indonesia (4)

- March/April 1998: General recognition emerged of need for demonstrating a comprehensive approach to handling the crisis.
- IBRA began developing objective criteria for the handling of the banks: all banks with liquidity support over 500 percent of capital to be closed, all with over 200 percent support to be taken over.
- PR firm hired from Hong Kong to advise on presentation of strategy.

Financial Crisis: Indonesia (5)

- Interventions announced and undertaken over first weekend in April 1998.
- Careful sequencing of presentations showing collaboration of finance ministry, central bank, and IBRA, and giving full explanation of actions.
- Reassurance to depositors through adverts in newspapers announcing closures of banks and opening of accounts of those banks’ depositors at selected state banks.

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Financial Crisis : Indonesia (6)

- Problem: lack of full surprise, since some owners were in the government (part of effective communication is not communicating until one is ready): added to costs of the closures.
- Problem: lack of credibility in the announcement: continued bank runs.
- Problem: delays in securing legal powers meant that IBRA could not quickly seize the assets of the closed and taken-over banks.
- Nevertheless, after a short period, as depositors were able to access their funds, and broadly consistent policies were maintained (and endorsed by the IMF), the runs ended and were reversed: no systemic runs recurred despite later policy difficulties.
- Overall, showed benefits of well-thought out presentations of the comprehensive policy strategy.

Afterthoughts

- Averting, or mitigating, a crisis a major part of policy making.
- Important element of this is contingency planning.
- Planning for extreme downside scenarios does not imply forecasting them, rather ensuring that responses would not have to be developed on the hoof if a crisis emerges.
- In many cases such planning done in extreme secrecy, with deniability.
- Including a communications strategy an integral part of any such planning. If a strategy cannot be communicated effectively, it cannot be implemented effectively.

Conclusion

- Transparency an integral element of central bank operations for both monetary and financial stability, both for increasing operational efficiency through establishing credibility, and for underpinning accountability and thereby safeguarding central bank independence.
- Attention to communications important for ensuring that the central bank gains the benefits of its transparency.