Reflections on communication by a former Reserve Bank of India governor

Duvvuri Subbarao conducts Reserve Bank of India press conference, Mumbai, January 27, 2013.

The SIGNAL and the NOISE

Duvvuri Subbarao

ONE of the nice things about being a central bank governor is that the markets hang on every word you say, treating every syllable, nuance, and twitch of the face as a market cue. One of the stressful things about being a central bank governor is that the markets hang on every word you say, treating every syllable, nuance, and twitch of the face as a market cue. That about sums up both the opportunity and challenge of central bank communication.

Virtually all central bank governors have taken an ego trip on the magic of the words they spoke or rued the fallout from some miscommunication. Experience helps but doesn't guarantee that markets will not deem what you said something other than what you believe that you said. I learned along the way—and sometimes the hard way.

There are powerful examples from around the world of how central banks have exploited the power of communication to enhance their policy effectiveness. Hours after the 9/11 terrorist attacks on the United States in 2001, the U.S. central bank put out a simple statement: "The Federal Reserve System is open and operating. The discount window is open to meet liquidity needs."

These two seemingly banal sentences, coming so soon after the attacks, had a remarkably calming effect on U.S.—and global—financial markets. The "announcement effect" was striking.

Similarly, when the collapse of the euro seemed imminent, European Central Bank President Mario Draghi's famous words in April 2012 that the central bank would do "whatever it takes" did more to save the euro than all the euro area leaders' exhausting summits, emergency conclaves, and emphatic communiqués.

The positive impact of communication is not limited to times of crisis, however. Today's conventional wisdom is that greater transparency, active outreach, and more open communication are always good for central banks.

Modernizing monetary policy

As an institution, the Reserve Bank of India is deeply sensitive to its responsibility to communicate with the public—not just on monetary policy but on the entire range of its broad mandate, which includes financial market developments, external sector management, regulatory issues, printing and distribution of currency, and economic development.

Giving forward guidance on monetary policy was a big and challenging institutional innovation introduced during my time. At the heart of forward guidance is an indication by the central bank to shape market expectations of how it would react to evolving macroeconomic developments, allowing market participants to make necessary adjustments.

Forward guidance on monetary policy was and is a contentious issue. At the Reserve Bank, we deliberated internally over whether to adopt the practice. We recognized that it is not a totally benign option, but decided to go ahead because we felt that the benefits outweighed the costs—especially given continuing global uncertainty.

Forward guidance is typically one short paragraph in a six- to eight-page policy document, but crafting it can be a test of communication skills. Aware that there is a minor industry whose purpose is to parse these few sentences and probe for coded messages behind the plain English, we spent a disproportionate amount of time debating the choice of words, the turn of phrase, and the nuance.

Along the way, we discovered several inherent challenges in giving forward guidance. For one, a central bank's indication of how it is likely to act in the future depends on economic developments. But markets tend to ignore the caveats and interpret the guidance as an irrevocable commitment. As a result they find themselves on the wrong foot when things don't turn out as expected. For example, in our policy reviews both in October and December 2011, we said that "the cycle of rate increases has peaked and further actions are likely to reverse the cycle." This generated a widely shared expectation of a rate cut at the January 2012 policy meeting, an expectation that did not materialize because inflation had not trended down as anticipated. Even though our inaction was consistent with the guidance, the market was unforgiving and believed we had reneged on our commitment.

Moreover, when financial conditions are uncertain, markets more than ever want greater and more specific guidance, but that is precisely when central banks are least able to deliver. In our November 2010 policy statement, we said: "Based purely on current growth and inflation trends, the Reserve Bank believes that the likelihood of further rate action in the immediate future is relatively low. However in an uncertain world, we need to be prepared to respond appropriately to shocks that may emanate from either the global or the domestic environment."

Our guidance reflected domestic uncertainty about agricultural prospects and their impact on growth and inflation and external uncertainty arising from the euro area sovereign debt crisis. Many analysts thought the guidance—especially the signal to markets of possible rate action if actual outcomes deviated from expectations—was helpful; a few, however, considered it too vague to be of any use.

As we moved on, I realized that markets demand not only guidance but "guidance on guidance"—in other words, an explanation of what the guidance means. This can be tricky because a lot of thought goes into the wording, and attempts at further explanation risk distorting the message.

For instance, at the postpolicy media conference following the November 2010 guidance cited above, I was pushed to elaborate on the meaning of "immediate future." I replied that what we implied by "immediate" was around three months, thereby suggesting, although not saying so explicitly, that there would be no policy rate hike at the December 2010 midquarter review, which was six weeks away, and that a hike would be considered only at the following quarterly policy review, three months away. This elaboration triggered criticism that the three-month pause implied by the guidance was too dovish and did not sit tidily with our statement of risks to inflation. We could have avoided the criticism by refraining from guidance altogether, but we felt it was in keeping with best practice and was our obligation to the markets.

How you say it

Even as the Reserve Bank has moved to modernize monetary policymaking, the traditional challenges of communication continue. What you say (or do not say) is important, but how you say it matters even more.

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In the midst of the so-called taper tantrum, on July 15, 2013—when global markets reacted badly to hints from the U.S. Federal Reserve that it might raise interest rates—I took the extraordinary step of raising rates to manage the exchange rate ahead of the regularly scheduled quarterly policy review. Quite understandably, the decision attracted a lot of commentary and the usual share of compliments and criticism. At the scheduled review on July 30, I saw no case for further policy adjustment and simply reiterated the need to correct domestic structural imbalances to bring stability to the external sector.

The postpolicy media conference that afternoon was to be my last as governor. I had been looking forward to this conference and expecting it to be somewhat of a farewell engagement. Instead of a serious question-and-answer session on substantive issues, we would reminisce about my five years as governor. That wasn't to be.

The first question was whether and when the monetary tightening measures instituted to manage the exchange rate would be withdrawn. The intent behind this unusual action was to squeeze systemic liquidity to curb speculation on the rupee and thereby send a strong signal to the market about the Reserve Bank's resolve to defend the currency. I replied that these measures were temporary and would be rolled back once the exchange rate regained stability, that the bank was sensitive to the short-term economic costs of tight liquidity but I was in no position to be locked in to a rollback time frame. My intention was to allay market fears that the tight liquidity policy would choke incipient growth in the economy at a time of growing concern about rapidly declining economic activity.

The market reacted very badly to my response, and the rupee fell from 59.63 to the dollar to 60.48 by market close that day. I was criticized for sounding apologetic about my decision to use monetary policy to defend the exchange rate. Critics said that my concern for growth was misplaced when the market expected the Reserve Bank to focus on the exchange rate to the exclusion of all other concerns.

I realize now that I may have been guilty of miscommunication. I should have known that when the rupee was under such pressure, being firm and assertive on the exchange rate was far more important than giving reassurance on growth.

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At the same time, I was puzzled by the market reaction, because my reply was almost identical to our statement in the printed document. The consensus among my senior advisors was that the criticism of "apologetic tone" stemmed not so much from the exact content of the reply as from the nuance and perhaps the body language.

Even as I was close to finishing my job as governor, I had not yet learned a rookie lesson in communication: markets don't take what the governor says at face value. At least, I had learned to be opportunistic, slipping in guidance or correcting misinterpretation in speeches or in informal interviews! I used an analysts' teleconference the following day to correct this misinterpretation. While replying to a related question, I asserted the "Reserve Bank's single-minded commitment" to stabilizing the rupee and added that in the given context, the benefits of rupee stability outweighed any short-term sacrifice of growth. This was entirely consistent with what I had said at the media conference the previous day, but rephrasing it this way conveyed the message the way the market wanted to hear it. I corrected for the nuance too. The previous day, I had said that *these measures will be withdrawn when* the rupee became stable. Now I made a subtle change to affirm that *these measures will not be withdrawn until* there was firm evidence that the rupee had stabilized. Maybe that sounded alpha male enough. The market reacted positively, and the rupee swiftly reversed the losses of the previous day.

Learning is an unending task, and my education in communication continued right up to the close of my tenure. I learned, for example, that being too direct or explicit is sometimes inadvisable. At the postpolicy news conference on October 30, 2011, I was asked whether the Reserve Bank would intervene in the foreign exchange market to build up reserves, and I responded directly: "No, we would not." My answer should not have surprised anyone or caused anxiety. I was just stating the obvious, that under the Reserve Bank's declared policy the only condition that would trigger foreign exchange intervention was exchange rate volatility. However, the rupee came under heavy pressure the next day, and some analysts faulted me for being too explicit and suggested that whatever the intent, I should not have been so direct.

I also learned, several times over, that nothing the governor says is off the record. For example, in mid-January 2013, I was speaking at the Indian Institute of Management at Lucknow, explaining to the students how the tension between growth and inflation is overplayed and why low and steady inflation was necessary for sustained growth. My remarks were not aimed at the here and now, but were meant to convey how hard it is to make a judgment call on a complex policy issue. The media interpreted my comments as a signal of further policy tightening at the coming policy review at the end of January, and it was all over the news agency tickers before I had even finished speaking.

And finally, I learned of the need to better shape my messages to ensure fuller and accurate coverage. For example, at a bankers' conference, I focused my comments on the efficiency of the Indian banking system and covered a host of issues, including the relative efficiency of public and private banks; their asset liability management, credit standards, and customer service; and the use of technology. In passing, I commented on the salary structure of public sector bank chairs and said that it needs to be reviewed to attract talent. I was puzzled by the way the media made it look as if I had devoted the entire speech to bemoaning the salary structure of public sector bank chiefs and the need to fix it to improve the efficiency of the Indian banking system. Follow-up articles and opinion pieces included extensive comparative analysis of the salary structure of public, private, and foreign bank CEOs. Some media analysts even put the measly salary of the Reserve Bank governor in their comparative charts. Much of this reporting was constructive, but I feel that the larger issues of banking system efficiency should have made it to the commentary.

Mixed record

In my five years at the Reserve Bank, I was largely commended for bringing a culture of openness to a conservative and inward-looking institution and was complimented for making the bank more transparent, responsive, and consultative; for listening as well as speaking; for streamlining our written documents and simplifying our spoken language. On the flip side, I was criticized for showing self-doubt and reticence instead of conveying certainty and confidence, for straying from the message, and for too much straight talk and too little tact. I was both praised for speaking up and criticized for not speaking enough when the occasion demanded. Some analysts thought that I was not the überconfident, alpha male central bank governor markets respect; others thought that it was, in fact, my low-key demeanor and low-profile personality that commanded respect and aided effective communication. I will let it rest there.

There are many things I miss about being governor. One of them is that I can no longer move markets by my spoken word. Equally, there are many things I enjoy about not being governor. One of them is that I can speak freely without any fear of moving markets. ■

Duvvuri Subbarao was Governor of the Reserve Bank of India from 2008 to 2013. This article is based on a chapter in his forthcoming book, Who Moved My Interest Rate?