

# The Three Faces of Transparency

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# Transparency

- We naturally think that “more” is better?
  - That’s how transparency indexes are created (Siklos 2002, 2017; Dincer & Eichengreen 2014)
- We under-appreciate the distinction between transparency & clarity
  - More can lead to greater confusion, complexity
- We also under-appreciate the relationship between transparency & credibility

# The Three Faces of Transparency

- Past: memory
  - Are bygones, bygones?
- Present: perception
  - How we see the world today?
- Future: its what we are mainly drawn to
  - Prospection
  - Foresight is critical and this is an area where CB have devoted too little effort

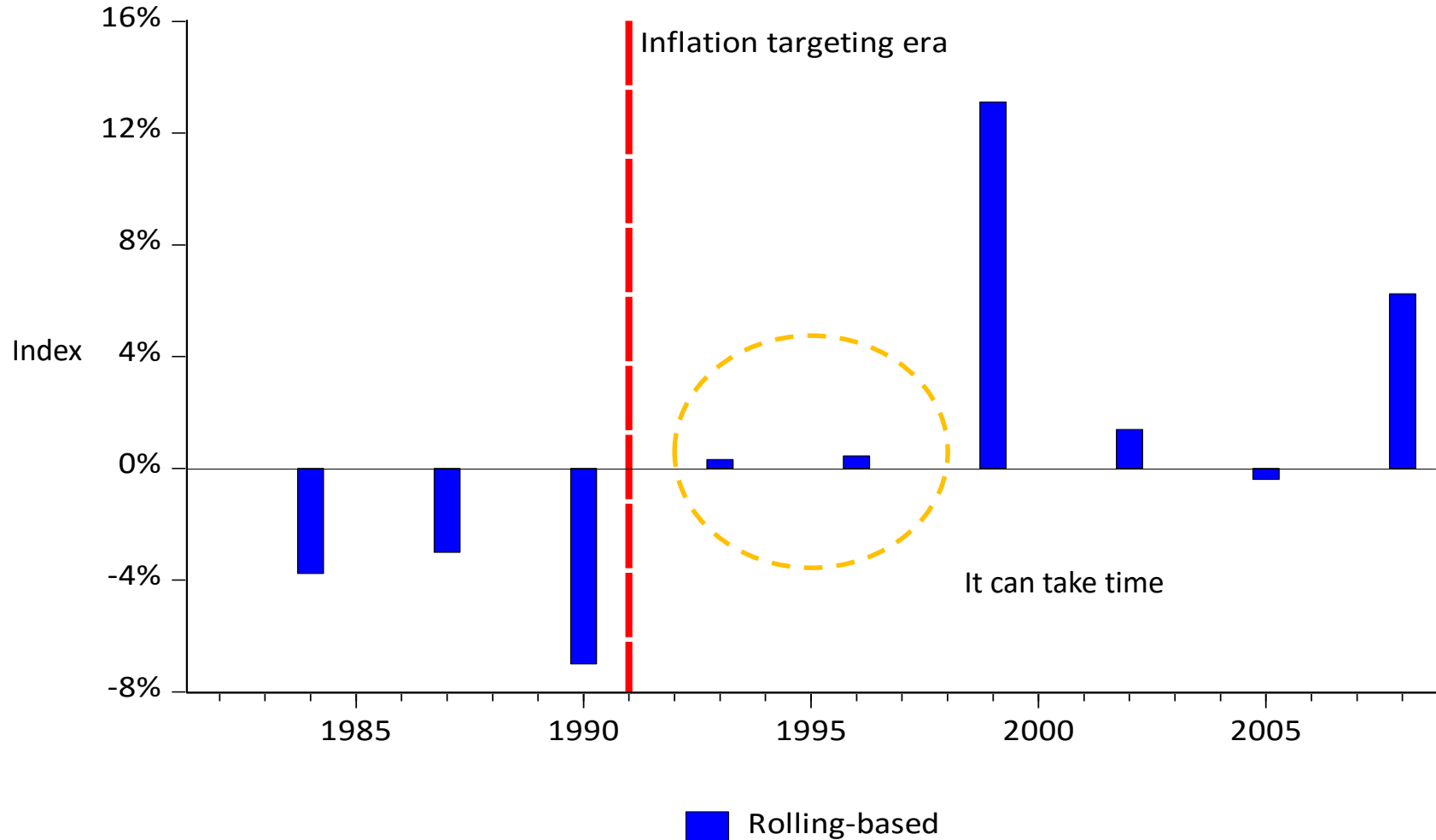
# Why the Future Matters?

- Markets and individuals focus on the unexpected (i.e., ‘surprises’)
- We do revisit the past but worry more about the future
  - Even when we are looking for something it is about predicting the future not revisiting the past
- In monetary policy circles:
  - there is an over-emphasis on how uncertain/risk-prone the future is
  - CB seem to be communicating more about how the future is bleak if they return to more normal monetary conditions too quickly but can’t define what too quick is

# Implications?

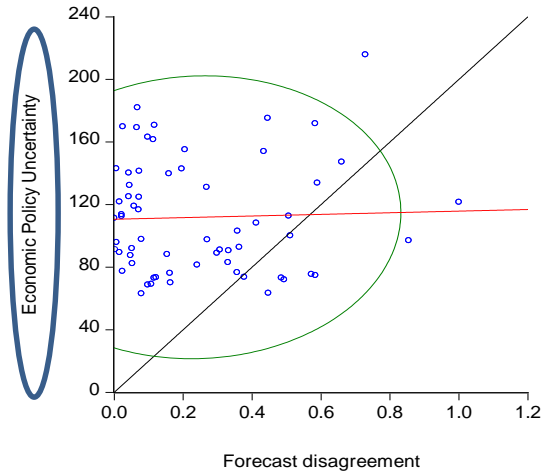
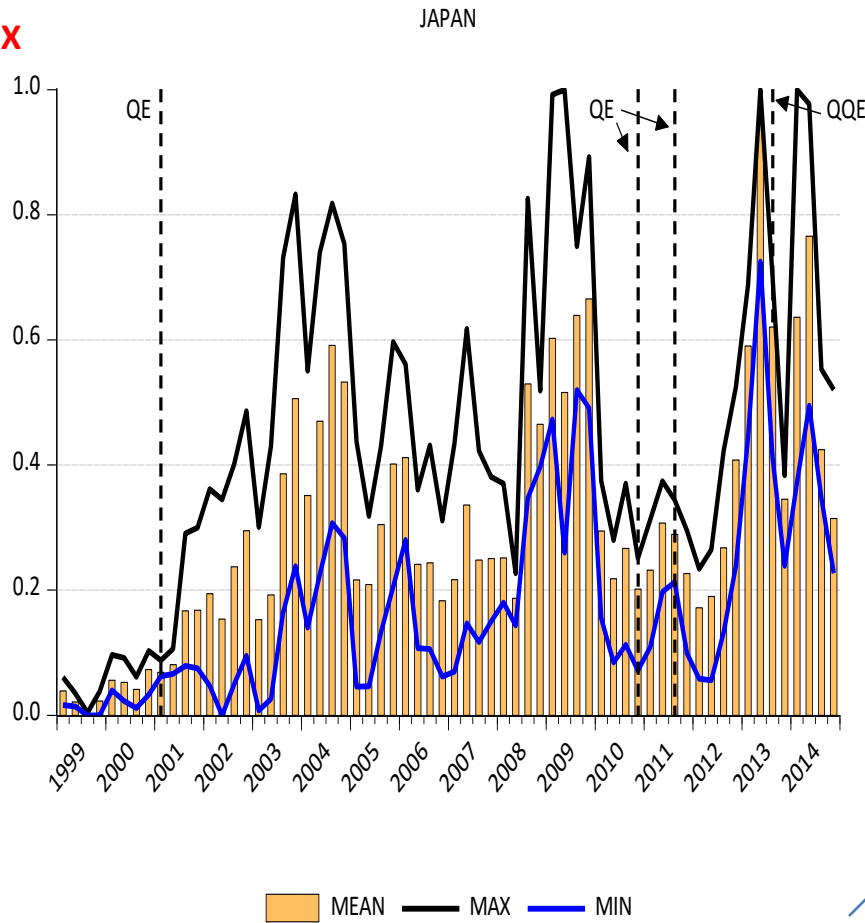
- Rather than communicate caution, which is fine under normal conditions, the foregoing view of the content of communication contributes to a loss of credibility (& trust)
- We don't have a consensus definition of credibility but we have workable ones
  - ones that focus on the IT target and only past performance miss the central role played by what markets & individuals think the future will hold . Ones that focus on point estimates miss the critical role about how we disagree about the future (Siklos 2013, 2017)
- The loss of credibility contributes to a lack of trust in the institution, another danger CB have largely avoided debating
  - Credibility is usually highest just before the 'fall' (Bordo & Siklos 2016)

# Bank of Canada Credibility

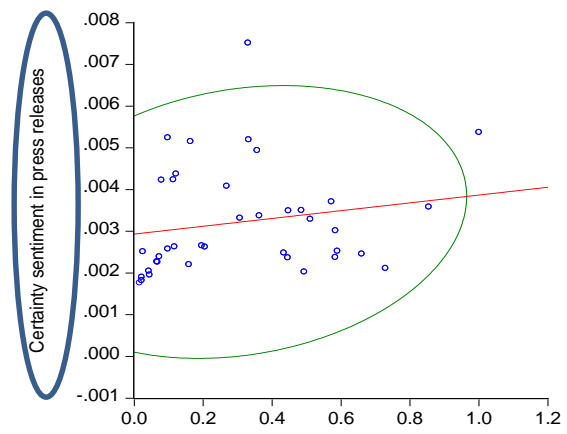


# Forecast Disagreement and Policy Uncertainty

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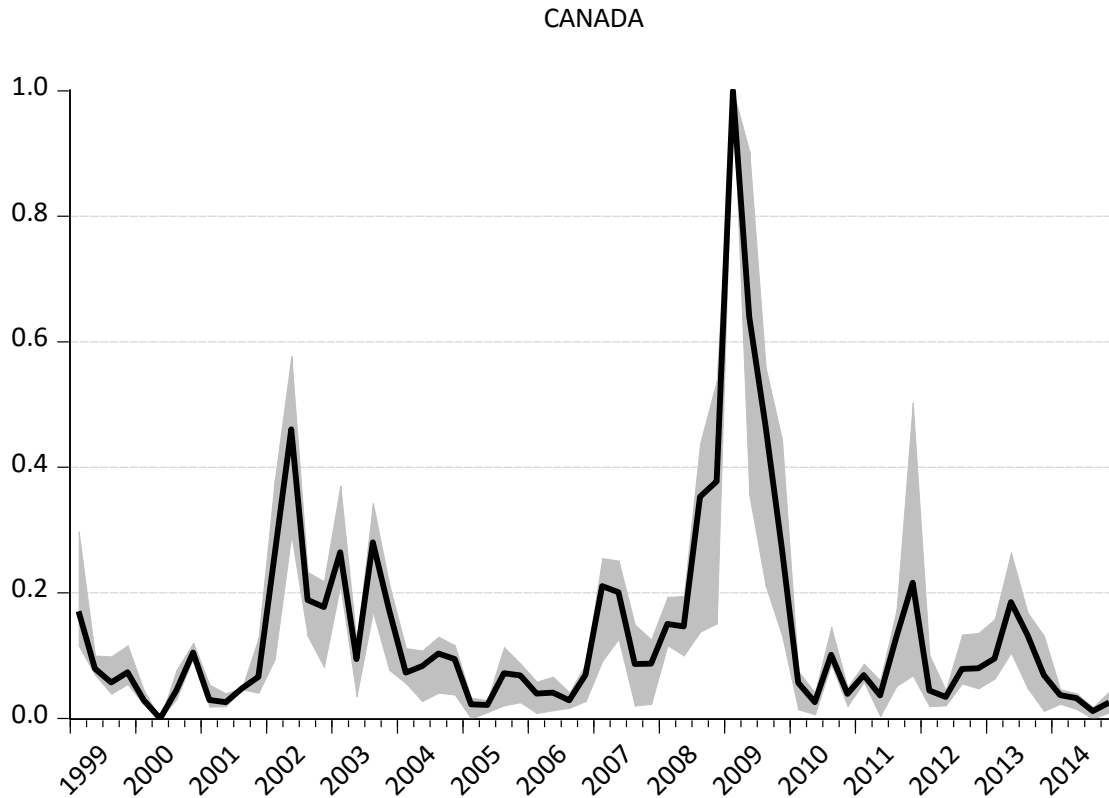
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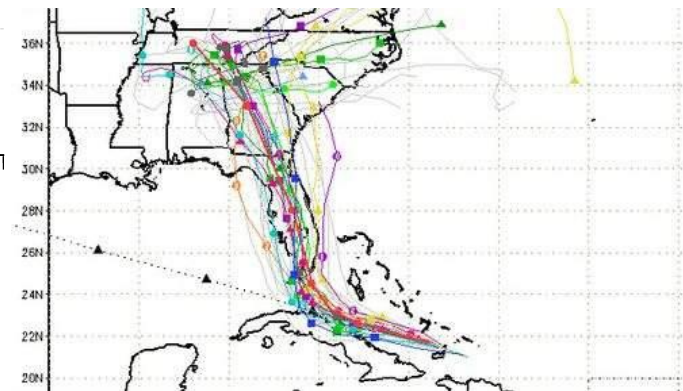
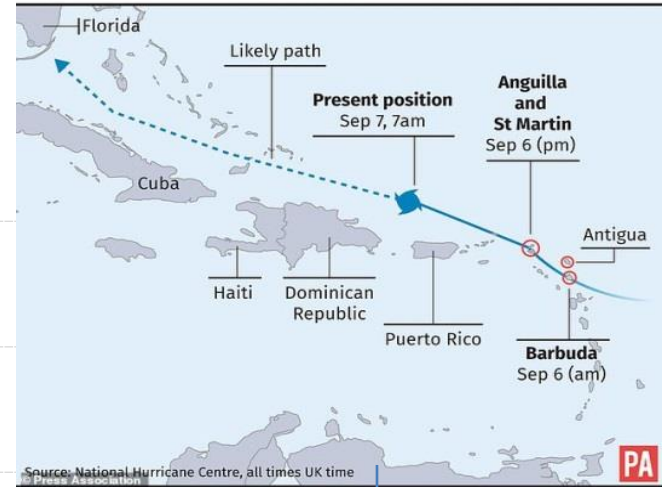
line of best fit    Ellipse

More certainty  
≈ less uncertainty

# Forecast Disagreement in Canada and a Way Forward?

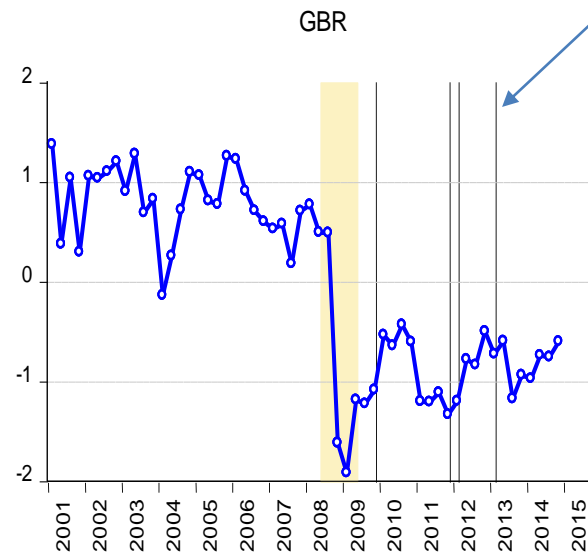
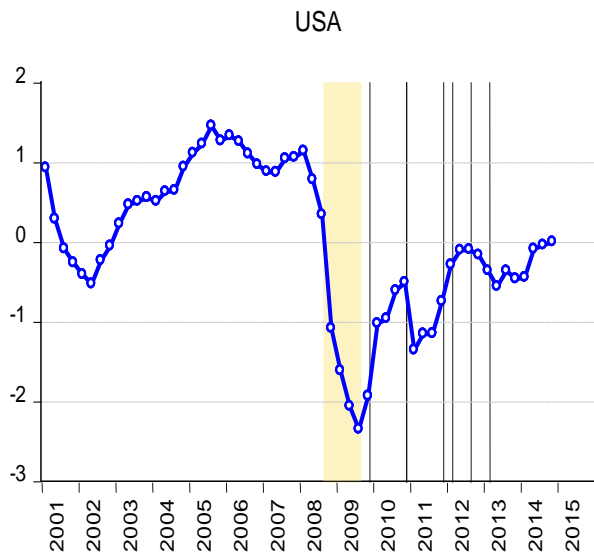


Hurricane Irma's trail of destruction



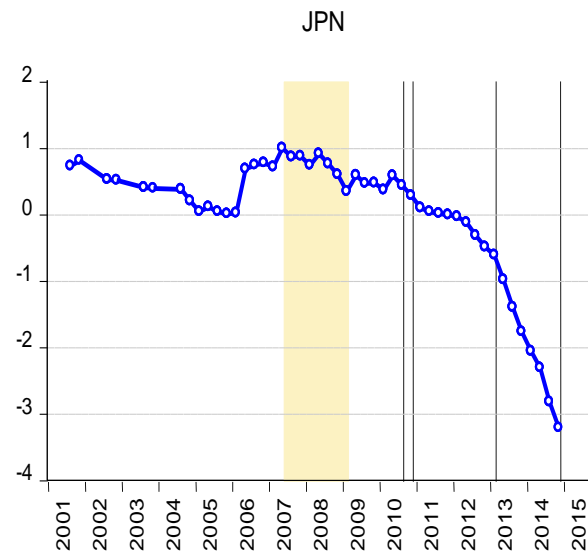
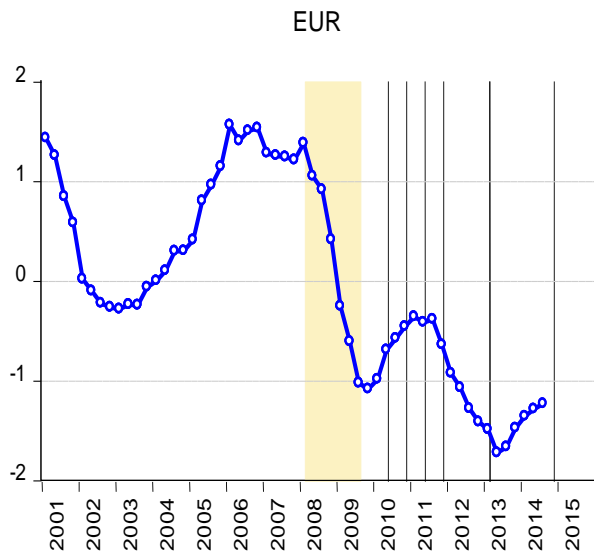
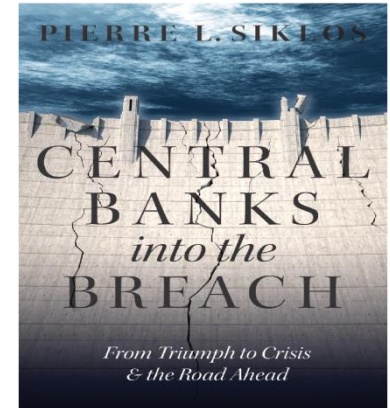


# The Evolution of Trust in Central Banks



Central bank interventions

Source



Note: The estimates are based on the first principal component consisting of the inflation and real GDP growth forecast errors, the long-short interest rate spread, the VIX, the share of central bank assets to GDP, indicators of credit growth and the optimism content in central bank press releases. The online appendix contains more details. GBR is the United Kingdom, EUR is the Eurozone, and JPN is Japan. The shaded areas highlight the period of the GFC while the vertical lines indicate various forms of central bank interventions (i.e., various forms of unconventional monetary policies).

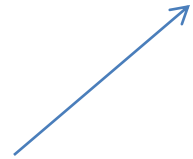
# What About MP Surprises?

CHANGE FFR ONE MEETING TO THE NEXT = DAY OF THE FOMC MEETING SURPRISE + INTER-MEETING REVISIONS IN FFR TARGET + EXPECTED CHANGE IN FFR AS OF PREVIOUS FOMC MEETING

$$r_t^T - r_{t-k}^T = \underbrace{(r_t^T - f_{t|t-1})}_{\textcircled{1}} + \underbrace{(f_{t|t-1} - f_{t|t-k})}_{\textcircled{2}} + \underbrace{(f_{t|t-k} - r_{t-k}^T)}_{\textcircled{3}}$$

“KUTTNER” SURPRISE  
New information

- With no communication and low transparency, the variance of the day-of-meeting surprise ① will be large, relative to the variance of the inter-meeting forecast revision ②. In other words, the markets don't know what the Fed is going to do until the day of the meeting.
- With high communication/transparency, the opposite will be true: small variance of the day-ahead surprises, relative to the variance of the inter-meeting forecast revision.



NEW ELEMENTS: HOW MUCH OF NEW INFORMATION IS FROM MACRO DATA RELEASES, SPEECHES, CONTENT OF MINUTES AND STATEMENTS.  
SIGN REVERSALS CAN INFORM ABOUT MARKET 'CONFUSION'

# Bottom Lines

- Credibility (and trust) are fragile
- The degree of inflation anchoring is also more fragile than we think
- Focusing on point forecasts misses an important communication element that contributes to transparency
  - Shifting emphasis on communicating future prospects in one area where CB can improve the delivery of MP

# References

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