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How transparent do the central banks want to be?
By Francesco Giavazzi and Charles Wyplosz

Sir, Whether or not central banks should make their interest rate forecasts public - an issue raised by Charles Goodhart (Letters, June 29) in his comment on our article (June 28) - warrants a further exchange.

Prof Goodhart makes five points. First, central banks only react to unexpected changes in the economic outlook; thus changes in interest rates are unpredictable and therefore cannot be forecast. This is not what we seem to see: there are long periods of raises followed by long periods of cuts. In his interpretation, this can only happen if unexpected changes in the outlook are correlated, systematically improving for a while and then systematically worsening. But then, should this not be picked up by forecasts? What we see, instead, is that central banks operate at the business cycle frequency: monetary policy is tightened and loosened in times of upswings and downswings, respectively.
Second, central bank forecasts are of little information value since they are based on the same information available to private sector forecasters. This is incorrect: central banks have some information the market does not have. What could this be? It is precisely the path of interest rates that the central bank plans to follow in the future, given the available information, and which it can and should use in producing its inflation forecast.
Third, central banks should not be fully transparent because their unavoidably imperfect forecasts may be over-interpreted by the markets. This is a result derived by Stephen Morris and Hyun Song Shin in earlier research. Unfortunately this result does not quite survive when account is taken of the fact that central banks must anyway reveal their current interest rate.
Fourth, members of a monetary policy committee would find it very difficult to agree on a future path of interest rates. Every month, the Bank of Norway shows that this is doable, and we believe this is a healthy exercise that should sharpen MPC debates. And, by the way, if MPC members accept an inflation forecast they must also accept the interest rate path used to produce such a forecast.
Finally, central banks would lose credibility when their interest forecasts were proved inaccurate. We recognise that quite often these interest forecasts will not match subsequent decisions, but we do not see why this should hurt central bank credibility. As long as forecasts are presented as conditional on current information, such discrepancies are only to be expected. What is needed is an explanation of which new piece of information has led to a change of view. This is what transparency is all about: ex post, transparent central banks are almost always wrong, like any human being.

In the end, the question is one of how transparent central banks want to be. The Bank of England used to be at the leading edge of transparency: it is now being overtaken by others.

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