

Discussion of Sally Auld's talk/paper

Discussion by Jens Iversen, Deputy head, Monetary Policy Department, Sveriges Riksbank

It's a great privilege to be asked to discuss this insightful paper. Sally's perspective as a long-time consumer of CB communication provides valuable insights, particularly into how communication has shifted from being purely informational to becoming a tool of policy. Her user-oriented approach is useful in understanding the broader impact of CB communication, especially regarding how it is received by different types of market participants. I will focus on three particular themes of the paper:

- The substantial changes in central bank communication and transparency that has happened over the last 20-30 years.
- The importance for central banks of communicating their monetary policy reaction function.
- That central bank make mistakes – and they need to learn from these mistakes.

Substantial changes in central bank communication and transparency have occurred over the last 20-30 years

The paper provides a thorough background on the topic of central bank communication. It presents the author's reflections on the evolution of central bank communication over the last 20-30 years. It also contains a discussion regarding the particular communication style of the last four RBA governors, as well as the potential impact of RBA communication on financial market volatility of RBA communication over the years.

The conclusion of the paper is that, overall, RBA communication has been successful since it has contributed to sustaining the credibility of the RBA. Evidence for the latter is that long-run inflation expectations have kept within the target band during the past three years.

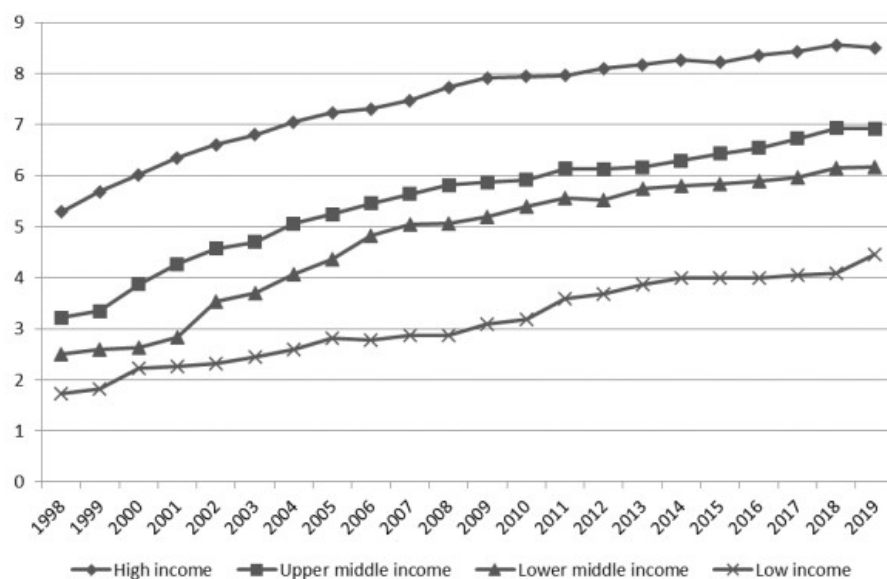
The Riksbank experience

The Riksbank's communication strategy reflects the strong priority that the bank gives to transparency. There are many benefits to being transparent. As for many other central banks around the world, transparency helps us manage the expectations of agents in the Swedish economy. It is therefore an important monetary policy tool. Transparency also facilitates accountability, which is an important underpinning of independence. Furthermore, transparency is a crucial for external scrutiny and evaluation of monetary policy. The latter, in turn, forces us to continuously improve our analysis and reasoning.

This can be summarized by quote from Sally's paper: "What has changed? A lot!". In Figure 1 that statement is quantified, using a chart from a paper by Dincer, Eichengreen and Geraats (2022).¹

¹ Dincer, N., B. Eichengreen, and P. Geraats: "Trends in Monetary Policy Transparency around the World", *SUERF Policy Brief*, No 322, April 2022.

Figure 1. Transparency in monetary policy by level of economic development



Source: Dincer, N., B. Eichengreen, and P. Geraats: "Trends in Monetary Policy Transparency around the World" , *SUERF Policy Brief*, No 322, April 2022.

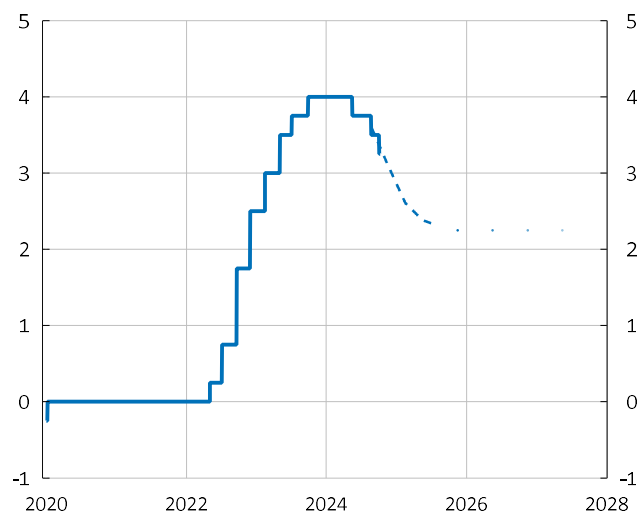
In Figure 1 we see that central bank transparency has indeed increased substantially, in both high- and lower income countries. In fact, transparency has not only increased in inflation targeting countries but in countries with other monetary regimes as well.

The importance for central banks of communicating their monetary policy reaction function

In the paper, Sally argues that communicating the monetary policy reaction function has always been the bedrock of central bank communication. This is in line with the reasoning at the Riksbank. We continuously strive to be as clear as possible about the way we will respond to macroeconomic developments. Let me provide two examples.

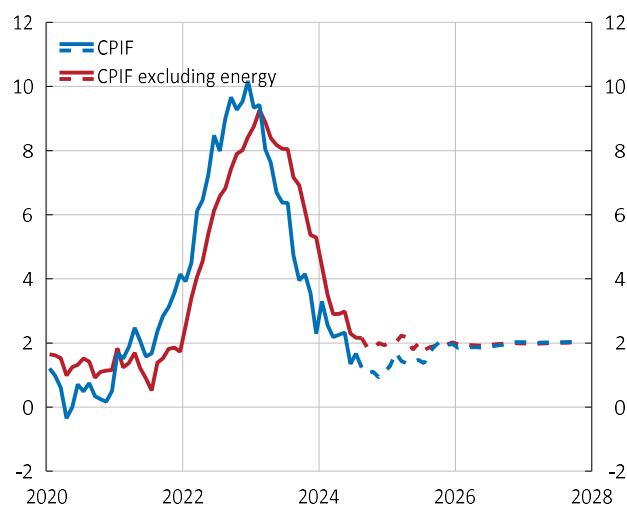
The first example is by publishing an extensive amount of information. In connection with every other monetary policy meeting, a full range of forecasts for macroeconomic and financial variables is published, including a forecast for the policy rate. Figures 2 and 3 are from the September Monetary policy report (MPR) this year and shows the forecasts for headline- and core inflation and the policy rate. These forecasts are consistent with each other in the sense that the policy rate forecast is conditional on the forecast for inflation and all other macro variables, while the forecasts for the macro variables are conditioned on the future path of the policy rate. As these forecasts are "owned" by the board of the Riksbank they obviously incorporate the board's assessment of its own reaction function.

Figure 2. Policy rate forecast, percent



Source: Sveriges Riksbank, MPR September 2024. Solid line refers to outcome, dashed line represent the Riksbank's forecast. Outcomes for the policy rate are daily data and the forecasts refer to quarterly averages.

Figure 3. Inflation forecasts, annual percentage change

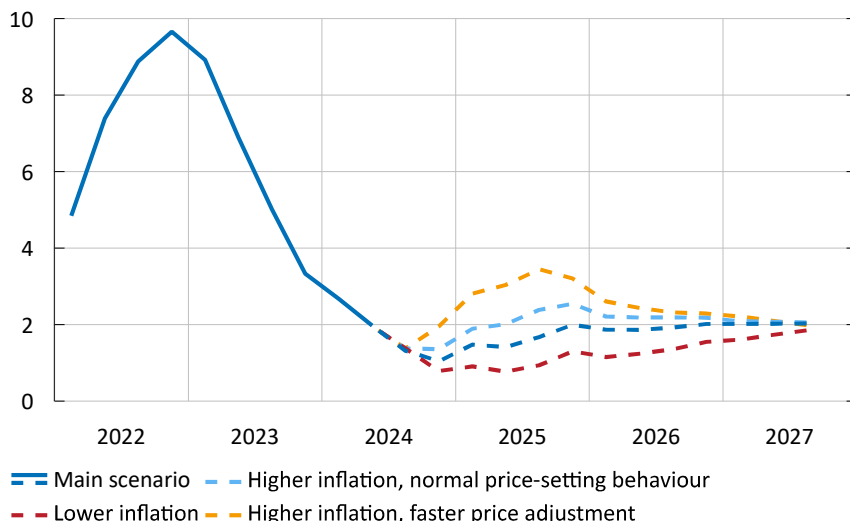


Sources: Statistics Sweden and Sveriges Riksbank, MPR September 2024. Solid line refers to outcome, dashed line represent the Riksbank's forecast.

The second example on how we try to communicate about the reaction function is by publishing alternative scenarios that include alternative paths for the policy rate. Figures 4 and 5 show the scenarios that were published in the MPR in September 2024. In Figure 4, the development of headline inflation in three different alternatives and the main scenario is shown. Figure 5 shows the board's assessment of how monetary policy (or the policy rate) is likely to develop in these scenarios.

Figure 4. The forecast and alternative scenarios for CPIF

Annual percentage change

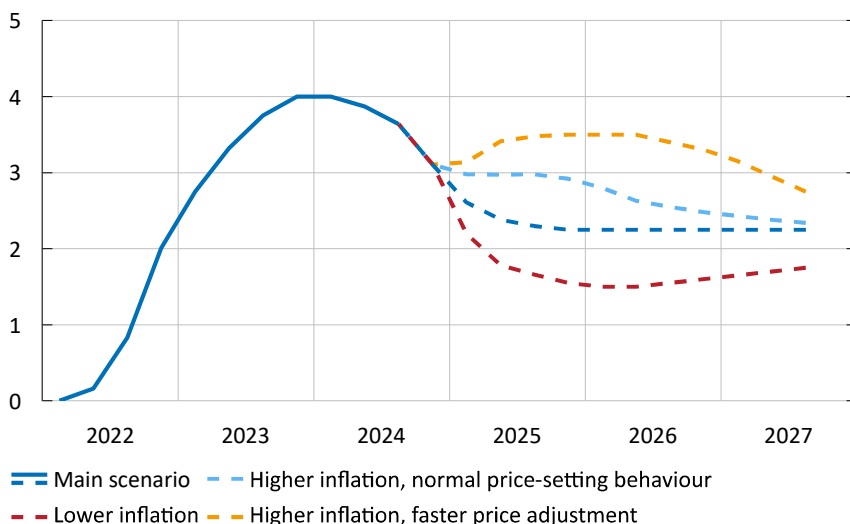


Note. Solid line refers to outcome, dashed line represents the Riksbank's forecasts and scenarios. Quarterly averages.

Sources: Statistics Sweden and Sveriges Riksbank, MPR September 2024.

Figure 5. The forecast and alternative scenarios for the policy rate

Per cent



Note. Solid line refers to outcome, dashed line represents the Riksbank's forecasts and scenarios. The deviations from the forecast in the alternative scenarios are not symmetrical as they illustrate the monetary policy response to specific shocks to the economy. The asymmetry forecast shall therefore not necessarily be interpreted as the Riksbank seeing the risk surrounding the forecast for the policy rate as unbalanced.

Sources: Statistics Sweden and Sveriges Riksbank, MPR September 2024.

Showing how monetary policy will respond under various conditions is a way for the board to clarify their monetary policy reaction to these situations. The scenarios also serve the purpose of illustrating risks around the main scenario. It is important to communicate that, even though we think that the main scenario is the best forecast we can make, people need to be aware of and plan for different situations.

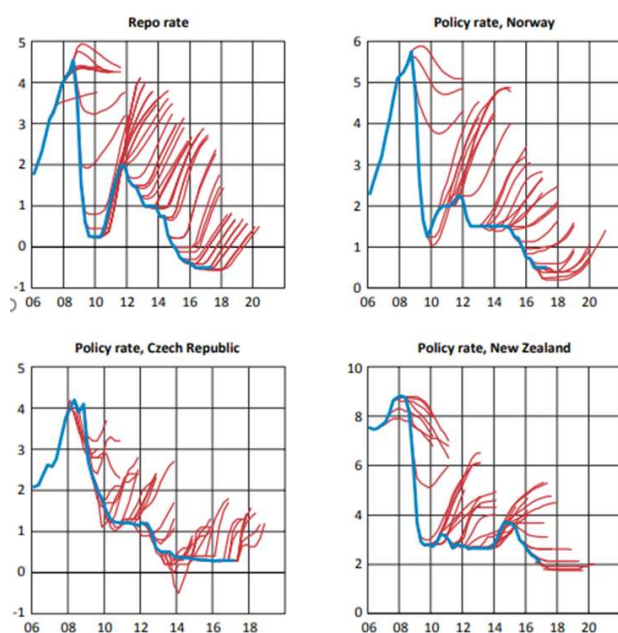
Central banks need to be continuous learners

A theme in Sally's paper is that central banks make mistakes and therefore need to have procedures in place that ensure that they keep learning from those mistakes. This is clearly true. In Figure 6 policy rate forecasts done by four different central banks up until 2017 are shown. The Riksbank is in the upper left hand panel. As can be seen in the figure, the Riksbank has been making substantial forecast errors regarding the policy rate forecasts. The bank was continuously projecting that interest rates would rise while in fact they kept falling. Similar patterns of errors are visible for the other central banks.

Finally, Figure 7 displays the root mean squared error of forecasts for inflation done by various central banks in 2021 and 2022. As can be seen in the Figure, the Riksbank's forecasts errors for inflation have also been substantial. The same is true for many other central banks.

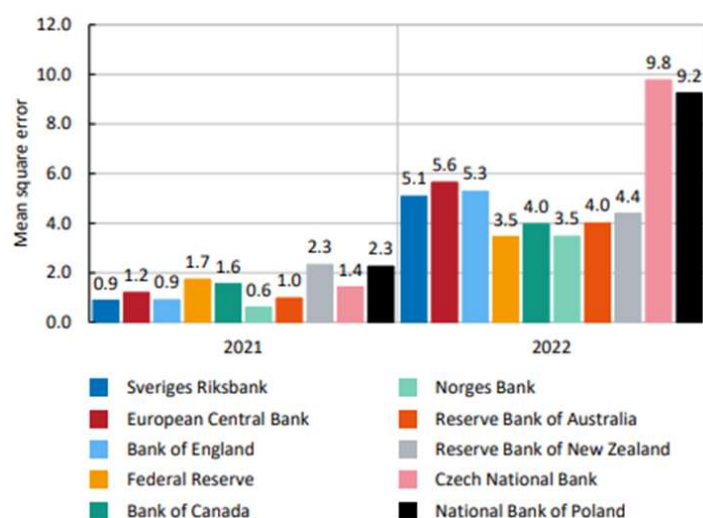
What these charts show is that central banks do make mistakes. It is worth mentioning though that market participants and other private forecasters also misjudged the interest rate development over the last 20 years. They were also slow to project the rise in inflation during 2022, so central banks are not unique in this regard. However, given the substantial policy-making powers allocated to central banks it could be considered particularly important that they learn from their errors and correct them as best they can.

Figure 6. The repo rate forecast and the policy rate forecasts in Norway, the Czech republic and New Zealand



Source: "The Riksbank's experiences of publishing repo rate forecasts", *Riksbank Studies*, June 2017.

Figure 7. Root mean square error of forecasts in 2020, 2021 and 2022 for inflation in 2021 and 2022 respectively



Source: Håkanson, C. and S. Laséen (2024) "Cruising to victory or a dead heat? Central Bank Championships in forecasting ability 2021 and 2022". *Economic commentary*. No. 1, Sveriges Riksbank.

One way to learn from mistakes is by having evaluations conducted regularly. In Sweden, the Riksbank annually publishes an Account of monetary policy that assesses goal achievement, forecasting ability and monetary policy over the past year.

Furthermore, the Riksdag's Committee of Finance regularly asks external experts to evaluate the Riksbank's monetary policy. This now occurs both annually – conducted by researchers at universities in Sweden – and every five years or so by experts from abroad. At the Riksbank, we find these evaluations helpful as they often pinpoint areas that we should pay more attention to and invest more analytical resources in.

Concluding remarks

I think the paper gives an interesting perspective on central bank communication. For me it was interesting to read about how communication is received. The paper also provides a thorough background, in particular concerning RBA communication. I think central bankers could learn a lot by reading the paper.