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Central Bank Communication and Monetary Policy: The Case of Central Bank of Nigeria

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Abstract

The importance of concise communication in monetary policy making cannot be over emphasised. A good communication of policy definitely strengthens the institutional independence of central banks and enhances the effectiveness of monetary policy. However, no one single method could fit all when it comes to designing good communication strategies because central banks face different constraints as they try to fine-tune their messages. With current reforms and financial liberalization, there is added impetus for increased communication between the Central Bank of Nigeria (CBN), market operators, stakeholders and the public in general. Monetary policy needs to be explained and well understood for the purpose of transparency and accountability.

1.0 Introduction

Communication is an integral part and a veritable tool for the implementation of modern day monetary policy. In the last few decades, central banking practice and the act of monetary policy has been evolving. In order to ensure openness in the monetary policymaking exercise, communication has become a veritable tool in highlighting the core mandate of central banks, especially in the areas of ensuring low and stable inflation. In terms of recent communication efforts, the Central Bank of Nigeria (CBN) is certainly in the right direction, although there is still room for improvement. This is because, the current reforms and financial liberalization has added impetus for increased communication between the Bank and all its stakeholders. In fact, effective communication has become a vital tool in the implementation of monetary policy for two main reasons. First, experience has shown that communication improves the effectiveness of monetary policy or, put another way, monetary policy is most effective when it is effectively communicated; and secondly, communication helps central banks to be more transparent and accountable.

Like all public policies, monetary policy benefits from increased public awareness and support. This translates into what can best be known as "legitimacy of policy." Through proper explanation of why some policies are introduced and certain actions are taken, central banks stand to gain more public support for what they are doing. When such confidence is established, greater expectations and trust tend to underscore good policymaking and favourable outcomes. In order words, with the clear recognition and appreciation of central banks objectives, agents in the economyconsumers, investors, businesses, financial market participants, and other stakeholders begin to adjust their behaviour in line with the expectation that future inflation will be relatively under controlled. Consequently, price, wage, and financial decisions will tend to be consistent with the targets. Thus, the net effect will be a more stable macroeconomic environment and greater success in keeping inflation low and stable.

Proper communication allows for a two way flow of information. In that case, to whom, should a central bank communicate? Two audiences seem critical. The central bank needs first of all to communicate with the broad public and its political stakeholders. This is because the virtues of central bank independence and price stability may not be self evident to the body politic. The central bank must constantly make the case that its job matters and that it is doing that job properly. To do so, it must address the concerns of ordinary citizens. This broad audience is best reached through the mass media, e.g. television and newspapers. What should this audience hear? The central bank needs to communicate its basic objectives, strategies for achieving them and its successes or challenges as well as failures with very good reasons. Consistency over time is crucial if public understanding is to be developed. The central banks' second audience is the financial markets. This is because monetary policy is transmitted through the markets to the rest of the economy. Thus the effectiveness of the policy will be greatly enhanced by open and clear communication between the central bank and the markets. Given that most of the treasury securities for the transmission of monetary policy have maturities that exceed the purview of the central bank, good communication should be able to identify the implications for longer period. To that end, the central bank needs to enlighten the market operators to think and process information as it does. This implies sharing with the market the broad objectives of the Bank's strategy, and even the tactical details. This is because the modern goal is to be so predictable that monetary policy decisions normally ratify market expectations- expectations that the central bank itself has managed successfully. According to King (2000), 'transparency should lead to policy being predictable. Hence a successful central bank should be boring. Therefore, the old communications principle, "Repeat, Repeat, Repeat," has become more appropriate because through its communication, the Bank is providing the opportunity for public critique of its economic analysis, by economists, financial market players, journalists and reporters, politicians, and the public more broadly. This is constructive since engaging the public in issues are important for broadening awareness and understanding of monetary policy.

The main objective of this paper is to examine current CBN's communication practices and challenges as well as highlight the need to be proactive in planning a communication policy for the Bank. The question is: Is the Bank doing enough in terms of its communication policy and contemporary central banking practice?.

The rest of this paper is organized as follows. Section 2 discusses the literature in central bank communication, while Section 3 reviews monetary policy in Nigeria as well as the CBN's communication channels and challenges faced. Section 4 highlights various elements of communication in practice by other central banks, and communication challenges are in Section 5. Finally, Section 6 proffers policy options and concludes the paper drawing largely from lesson of experiences.

2. A Review of Literature

The empirical literature on central bank communication is still in its infancy, but has been growing rapidly recently. However, there is a general consensus that communication is a powerful tool to further strengthen and move financial markets. Blinder (1998) and Bernanke (2004) emphasized the importance for communication as a means for central banks to influence asset prices in the financial markets, provided that the central bank has acquired a credible reputation. In that respect, communication is an important tool for the effectiveness of monetary policy implementation (Buiter 1999, Eijffinger and Hoeberichts 2004, Issing 2005). It is important that communication attempts to influence the expectations of economic agents, such that the desired reaction of longer-term interest rates is achieved.

In principle, communication can in parts even substitute policy action. Demiralp and Jorda (2004) provide evidence that by announcing changes in the intended federal funds rate since 1994, it was possible for the Federal Reserve to move the federal funds rate with a smaller volume of open market operations, which indicates clearly that increased transparency and more communication can indeed be beneficial for the efficiency of policy implementation. Moving one step further, there might even be an effect on financial markets if the central bank communicates its views about the intended level of asset prices and signals its intention to make the necessary adjustments in policy rates if asset prices deviate from this target, a policy that has frequently been labeled "open-mouth operations" (Guthrie and Wright 2000, Thornton 2004).

On the other hand, several authors have argued that there might be a trade-off in that more communication need not always be optimal. King (2000) argues that a central bank should be highly transparent about its monetary policy reaction function and its target. Beyond that, however, a central bank should refrain from "creating" news instead, news should entirely arise from information about the development of the economy. The central bank also faces a trade-off when giving a lot of information induces not more but less clarity and common understanding among market participants, as there are limits to how much information can be digested effectively (Kahnemann 2003, Winkler 2000). The trade-off might become even more pronounced if the central bank communicates about issues on which it receives noisy signals itself, such as the revolution of the economy (as opposed to, e.g., its intentions regarding upcoming interest rate decisions). Amato, Morris and Shin (2002) argue that such communication can co-ordinate the actions of financial market participants away from fundamentals, in the sense that they attach too much weight to the central bank's views, not taking into account that they reflect a noisy signal. On the other hand, Svensson (2005) suggests that such an outcome is rather unlikely under plausible ranges for the model's parameter values. In sum, however, it is clear that transparency is not an end in itself but merely a means to help the authority achieve its mandate (Issing 1999, Mishkin 2004). Guthrie and Wright (2000) reported this to be true for the Reserve Bank of New Zealand, Kohn and Sack (2004) for the Federal Reserve, and Reeves and Sawicki (2005) for the Bank of England.

Beyond its importance in normal times, communication has been highlighted as a particularly effective tool under the zero lower bound, i.e. when nominal interest rates are close or equal to zero (Bernanke, Reinhart and Sack 2004, Woodford 2005). There is even evidence that it is an indication about the future path of policy that moves financial markets (Ehrmann and Fratzscher 2005a, Gürkaynak, Sack and Swanson 2005).

Finally, some authors have analyzed the *content* of central bank communication. Gerlach (2004) develops a quantitative indicator from the assessment of inflation, economic activity and M3 growth in the editorial of the ECB's Monthly Bulletins, and finds that this indicator can explain interest-rate setting of the ECB. In a similar fashion, Rosa and Verga (2005) and Heinemann and Ullrich (2005) analyze the content of the ECB's introductory statements to the press conference following Governing Council meetings. They constructed indicators for the monetary policy stance of the ECB based on the words used in the statements, and showed that the indicators can explain interest-rate setting, although they serve as substitutes, not as complements to macroeconomic variables in Taylor-type rules.

3.0 Monetary policy at the

Central Bank of Nigeria

The Central Bank of Nigeria has adopted various monetary policy regimes since its inception in 1959. The different monetary policy regimes that were adopted include: the Exchange rate targeting regime; (1959 1973), Monetary Targeting Regime 1974 to present; Direct Monetary Control 1974 - 1992 and Indirect Monetary Control 1993 to present. These policy regimes have been on short term basis (annual) between 1959 and 2001. However, in 2002, the medium term perspective monetary policy framework was introduced mainly to address the lag in which monetary policy affect the ultimate objective in the short-term. This framework is aimed at freeing monetary policy from the problem of time inconsistency and minimizing over-reaction due to temporary shocks. This new monetary policy framework, which is still in operation, is based on the evidence that monetary policy actions affect the ultimate objectives with a substantial lag.

Under the framework, monetary policy guidelines are open to half-yearly review in the light of developments in monetary and financial market conditions in order to achieve medium to long term goals. The main objectives of monetary policy since then have been to achieve a low and stable inflation as well as maintain a stable exchange rate of the naira. There is also the need for a more competitive financial sector geared towards improving the payments system. The open market operations (OMO) has continued to be the primary tool of monetary policy, and is complemented by reserve requirements, discount window operations, foreign exchange market intervention and movement of public sector deposits in and out of DMBs.

In order to achieve its objective the CBN, has the responsibility of formulating and implementing monetary policy, as well as of deciding on matters pertaining to the conduct of monetary policy, to the Monetary Policy Committee (MPC). The MPC comprises the Governor (Chairman), the 4 deputy Governors, six departmental Directors, two external board members, one member appointed by the Ministry of Finance and the Secretary. The Committee, which used to convene every quarter, now convenes on a bi-monthly basis with effect from January 2007. The secretariat for the MPC at the CBN has also gone through a number of modifications over time. From being an ancillary function of the Research and Statistics Department to the recent creation of a full fledged department in 2005.

3.1 CBN Communication Channels

In its effort to clarify all aspects of its monetary policy, the CBN has overtime, established various communication channels with the public and market participants. Immediately after the MPC meeting the Governor holds a press conference in which he gives an introductory speech on the decision reached and the rationale behind it. This press conference includes a question and answer session, which is attended by various media representatives, and provides the platform for a timely explanation of the decisions. At the press briefing, the media also has the opportunity to ask questions about broader economic issues that are of importance to the public. Following the press conference a policy decision announcement is then posted on the CBN intranet. As soon as this is done, transcripts of the press conference become available on the website.

The detailed minutes of the MPC are not published. Although some central banks, such as the Bank of England, release their minutes to the public, the CBN follows the practice of the ECB by not making the minutes available for public consumption. In recent times, the MPC report provides a comprehensive analysis of the domestic and international economy. In particular, the report consists of the following five major sections: (a) international developments and exchange rates, (b) monetary developments, (c) inflation, (d) the domestic economy and (e) external transactions.

As part of its communication channel, the CBN is also statutorily obliged to publish an annual report on its activities during the previous year. Moreover, the law requires that the Governor should submit as the need arises, a report on past and current year developments both to the President and the National Assembly. The Governor may also be asked by different house committees to testify on subjects pertinent to monetary policy and the economy as a whole. Annually, the CBN organizes an annual conference of financial correspondents and the Governor meets with them during which the Bank's practices and views about a wide range of economic issues are examined and explained.

The Governor and the Bank's senior staff also constitute an important vehicle for explaining the views of the CBN to the public. They are often invited to give speeches or take part in panel discussions which are usually open to the public on subjects that include monetary and exchange rate policy, etc. The CBN also gives presentations to groups of students and experts who are always welcome to visit the Bank.

The Bank brings out a number of *ad-hoc* publications, which contain a wealth of useful information on national and international issues. Information on various facets of Nigerian economy is disseminated through the CBN publications, such as, Monthly Economic Report, Public Education Series, Handbook of Research Methodology, Statistical Bulletin, CBN Bullion, CBN Briefs, Economic and Financial Review and Occasional paper series. These publications contain valuable information useful to researchers and to the general public at large. The CBN also brings out special publications and monographs from time to time dealing with issues such as the problems of agricultural finance, micro finance etc which have a unique place in the economic information system in the country. There is also a document known as the Monetary and Credit Guideline, which used to be issued every year and is an important source of background information, especially for practitioners in the banking sector and the judiciary as well as the academia.

4. Communication in practice by some other central banks

It is now a known fact that central banks are now generally more open about most aspects of monetary policy. A remarkable change towards greater transparency has occurred in the past decade regarding central banks' objectives, policy instruments, decision-making procedures and policy decisions. The developments of inflation targeting frameworks in particular have improved the standards of communication strategies. Inflation targeting involves more than just the announcement of a numerical inflation objective. A significant feature of the regime is the communication structures put in place. This has opened a multitude of issues for policy makers to consider with regards to their overall communication strategies. Objectives and instrument targets have been announced; interest rate decisions are explained in a range of fora; and there is greater recognition of the interaction between the tactics of monetary policy and communication policies.

Before the advent of formal inflation targeting regimes, the ultimate goals of monetary policy were rarely specified explicitly. While secondary stabilization goals are normally not formulated precisely, the primary goal of low and stable inflation is now clearly enshrined in numerical point targets and ranges. The United States and Japan are two notable exceptions. Even the ECB felt compelled to provide the public with a numerical definition of its price stability objective. A publicly announced numerical target for inflation, if credible and feasible, can be an extremely powerful anchor for coordinating expectations. However, the confusion generated by the ECB's two-pillar monetary framework serves as a partial warning of the dangers in releasing numerical guidelines for policy. In some countries, such as the United Kingdom, an official explanation of the circumstances surrounding a breach of the inflation target must be provided either to the government or the public. Even in those countries not obliged to do so, the central bank is often eager to explain the reasons for target misses in order to help preserve its credibility. However, such explanations themselves become an important part of public knowledge.

In most countries reviewed except the United States and Australia, policy decisions are explained in press conferences and speeches. In fact, minutes are published by most of them, though with some delay after the end of the MPC meetings.

More generally, the views of the central bank are elaborated upon in monthly or quarterly periodicals, such as the Bank of England's Inflation Report or the ECB's Monthly Bulletin. Technical descriptions of its knowledge of the economy are sometimes dispensed in working papers. Central banks perhaps reach the widest audience through the popular press. Developing relationships with members of the press may be crucial in ensuring that an undistorted picture of the central bank's views is given a proper airing. But care must be taken by the central bank in explaining its past actions relative to past events in order to avoid introducing greater noise into the pool of current public knowledge. The problems involved are in order of magnitude, especially when the views of a committee of independent members are to be explained. The revelation of disagreements among committee members may confuse the markets, causing more harm than good; this view is shared by ECB and CBN who do not reveal precise voting results.

A more sensitive issue concerns the release of numerical forecasts of macroeconomic variables or indications of the future stance of monetary policy. Forecasts typically assume constant policy rates over the forecast horizon. But this assumption is unrealistic in most situations: both policy makers and economic agents alike often have good reason to expect that policy rates will be changed during the period of concern. This makes the interpretation of such forecasts more difficult than may appear at first. Alternatively, the Reserve Bank of New Zealand has published projections with an endogenous path for policy. While this approach is arguably more consistent internally, it ensues from the possibility that agents do not fully appreciate that projections are made conditional on the data at hand. In the end, more confusion may arise when policy rates inevitably depart from a path projected previously, not to mention the potential for damage to the central bank's credibility. All the same, central banks do provide indications of their views of future economic conditions and the future stance of policy. For instance, one device used by the Federal Reserve is to announce a “bias” along with a decision on the target for the federal funds rate. The bias provides a qualitative indication of the perceived risks to the economic outlook, and hence the more likely future course of monetary policy actions.

A brief summary of current communication practices is given in Table 1. At the cost of some generalization, practices can be broadly divided into means to improve the effectiveness of monetary policy and means to enhance central bank accountability. The former category can be further broken down between communication on policy decisions and on the central bank's assessment of economic conditions. As is evident from the table, there is considerable uniformity across central banks on certain elements of strategies aimed at making monetary policy decisions more transparent; For example, the adoption of explicit short-term targets for instruments and the public announcement of policy decisions (eg press releases). In addition, most central banks now regularly publish detailed descriptions of their views on the current and prospective state of the economy. However, there is less agreement on the detail and timing of explanations of policy decisions. For instance, not all central banks publish the minutes of policy meetings, and the lags in publication vary for those that do.

Table 1: Summary of Current Communication Practices

	US	ECB	JAPAN	UK	NEW ZEL	AUSTRALIA	
Accountability:							
Quantitative inflation							
Objectives[1]	No	Yes	No	Yes	Yes	Yes	Yes
Report to Legislature[2]	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Policy Decisions:							
Decision announced							
immediately	Yes	Yes	Yes	Yes	Yes	Yes	Not always
Press conferences	No	Yes	Yes	No	Yes	No	Not always
Press releases	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Minutes published[3]	Yes	No	Yes	Yes	.	No	No
Precise voting result							
published	Yes	No	Yes	Yes	.	No	No
Economic assessments							
report on monetary policy	H[4]	M	M	Q	Q	Q	Bi-monthly
Forecasts released	H	H	H	Q	Q	Q	No
Quantitative risk							
assessments	No	No	No	Yes	No	No	No

U = Australia; UK = United Kingdom; JP = Japan; NZ = New Zealand; ; US = United States. M = monthly; Q = quarterly; H = half-yearly.

[illegible]

Australia: target range for medium-term average inflation.

2 United States: reports/testimony to Congress; ECB: reports/testimony to EU bodies; Japan: reports/testimony to Parliament; United Kingdom: reports to Treasury Committee; Nigeria: Report/testimony to the House of Assembly ew Zealand: reports to/hearings in legislature; Australia: reports to Parliament/testimony to House of Representatives Committee;

3 Publication lag: United States (five to eight weeks); Japan (one month); United Kingdom (13 days); Sweden (two weeks).

4 The Monetary Policy Report is provided semiannually; the Beige Book is published eight times a year.

Source: Various Central Banks

5. Communication Challenges

There are practical constraints on central bank communication strategies. These involves a situation where central banks might want in principle to release more information, there might be good for not to do so.

The first challenge is the fact that apart from the obvious inappropriate release of proprietary information, which could have a chilling effect on the future flow of such information to policymakers, improving communication is not costless. Clear communication requires time, money and central bank resources. Subjected to a serious cost-benefit analysis, releasing certain types of information might simply prove to be wasteful.

In addition, deliberations in policy meetings benefit greatly from full and frank discussions, which could be adversely affected by too much openness, such as broadcasting meetings or releasing complete transcripts as soon as would be possible. Similarly, enhanced transparency regarding policy deliberations, voting records and so on might induce the media to dramatise differences in opinion amongst policymakers, which in turn could politicise internal monetary policy discussions. All these concerns suggest that central banks must carefully consider what information they provide.

Another important issue is how the central bank can best get its intended message across clearly to the public that is mostly economic illiterate. There are several reasons why this is so challenging. First, language may be imprecise and subject to various interpretations, especially when policymakers feel the need to be concise. Consider, for example, the recent changes in the FOMC's post-meeting press release. Starting in mid-1999, the Committee indicated a "bias", along with its policy rate target, which provided a signal of what deviations from target might be likely during the inter-meeting period. Its full meaning, however, was not well understood in financial markets. Consequently, in February 2000, the statement on bias was replaced by the "balance of risks" statement. This was meant to indicate the FOMC's view of likely outcomes for inflation and output over a horizon beyond the subsequent policy meeting. Moreover, wishing to keep its statement brief, the Committee has had to choose its words carefully in order to best express its views. Their experiences have shown that even slight modifications in the balance of risks statement can cause a large, and sometimes unwanted, reaction in the markets. A longer statement, with greater emphasis on the conditions under which certain policy actions would be taken, might seem the obvious alternative but would necessarily delay its release to the public at the conclusion of an FOMC meeting. Moreover, it might unduly raise the sensitivity of markets to unfolding economic developments.

Secondly, while striving to be clear and predictable during normal circumstances, central banks might not find it feasible, or desirable, to describe all possible contingencies and what they might do in response. This is partly because of the impossibility of knowing the precise nature of events until they occur and partly due to concerns that the discussion of extreme contingencies might unduly influence the public and ruin financial markets. In addition, the difficulties may reflect the reality that the public may be unwilling or unable to fully digest complex analyses and a substantial amount of policy information.

Finally, because a focal point of communication strategies is credibility, an ironic question arises: can central banks appear to be too credible? A central bank may face a “winner's curse” problem: if it is too credible, the public may place more weight on its pronouncements than the central bank intended. This problem might be particularly relevant when policymakers make comments on low-probability outcomes, which the public then blows out of proportion. In such an environment, providing too much information may end up adversely affecting the central bank's credibility. Similarly, if the markets simply accept the central bank's assessment of how policy should evolve in the future, the two-way communication referred to above could become seriously compromised.

The pay-offs to better communication are potentially significant but, if history is a reliable guide, attaining such gains will most likely involve careful and prudent efforts rather than quick fixes.

6. Policy Options and Conclusion

6.1 Policy Options

History has shown that central banks strive for continuous improvement in their communication strategies. They also learn from the efforts of their peers, as has been evident in the trend towards the use of inflation targeting frameworks by many central banks around the world. The CBN is still fine-tuning policies and steps towards transiting to inflation targeting as its monetary policy framework. Therefore, discovering new communication modalities, as well as refining existing strategies, remains integral to future progress.

Consequently, *there are some options the* CBN would have to pursue now and in the period ahead.

v The level of *economic illiteracy* in the Nigeria at large is a particular problem for the CBN as in other developing countries. Thus, the Bank would have to embark on massive campaigns and sensitization programmes geared towards educating the Nigerian public generally about economic policies but especially on monetary policy issues. The language/dialects of the various ethnic groups should be the medium of communication. The target audience is Nigerians in the market places, schools at all level, and National Youth corp camps, National and State House of Assemblies and Nigerians in Diaspora etc.

- The Bank should actively promote economic education through a variety of publications and activities for schools in Nigeria. These could include an annual Monetary Policy Challenge for secondary school economics students, in which teams compete to produce simulated monetary policy advice.
- Internal *communication is equally as i*mportant with external communications, and various challenges arise in this connection. To this end, the newly established Monetary policy Department should carry out regular sensitization exercise to all the CBN branches. External communication is widely delegated among staff, which therefore needs to be well informed on what they communicate. But at the same time, there is need for clarity about who the central bank's spokesperson is, who is responsible for which information releases especially on sensitive issues, and on when staff are speaking for themselves and not the institution, for example on their research work.
- It is also necessary to have an economic calendar for the effective conduct of monetary policy which is the primary role of the CBN. Unlike fiscal policy and other economic policy formulation processes, monetary policy requires up-to-date and detailed information for effective formulation. Therefore, it would be expedient for the CBN to lead a process whereby information for decision making is regular and as much as possible available.
- Economic calendars present a detailed schedule for obtaining these indicators, thereby giving economic managers room to plan as data is made available when due.
- Finally, c*redibility* is an attribute needed by the CBN, and establishing it is a challenge when there is a recent history of inflation being on the increase and no central bank can establish or maintain credibility through communications alone. It is what you do, much more than what you say, that is important in this regard. Therefore, the Bank should intensify its developmental efforts like the Agricultural Credit Guarantee Scheme, Micro Finance Scheme, and the SMIESS, which are all poverty eradication efforts.

6.2 Conclusion

In conclusion, our concern is that one way the CBN can help stabilize the economy for growth is by reducing the expectations of uncertainty about its monetary polices framework and actions. It was not uncommon in the past for CBN to see a strategic advantage in withholding some information about decision, intentions and actions. This was largely predicated on the view that monetary policy actions could be more effective if they were not anticipated by the public. In recent times, this view is clearly becoming obsolete given the amount of reforms and liberalization. It has become imperative that CBN should ensure wider dissemination of information, clarity and buy-in by all economic agents. Furthermore, timely and relevant information is vital for efficient policy making and stabilizing expectations in an emerging economy like ours.

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