
Does it pay to be transparent? International evidence from central bank forecasts

Working Paper No. 143

Georgios Chortareas, David Stasavage and Gabriel Sterne

Is central bank transparency associated with lower inflation? This paper provides the first international evidence on if and how the degree of transparency in monetary policy affects policy outcomes. We focus on one particular form of transparency, namely the publication of inflation forecasts and forward-looking analysis. The recent theoretical literature suggests that transparency in publishing forecasts will reduce inflation to the extent that it makes central bank credibility more sensitive to policy actions. Recent policy debates have also highlighted the potential importance of the publication of the central bank's inflation forecasts.

We use a unique cross-country data set covering the detail with which central banks explain forecasts in 87 countries and we construct an index for transparency based on the publication of forecasts by central banks. We then assess how our index of transparency is related to inflation, inflation variability, output, and output variability. After controlling for a number of other institutional and macroeconomic variables we find that an increase in the detail with which central banks publish forecasts is associated with lower average inflation. The result holds regardless of whether the domestic nominal anchor is based more on an inflation or money target. Furthermore, we do not find evidence that the publication of forecasts is associated with greater output volatility.

One conundrum emerges, however: why, given the apparent benefits, do not more central banks publish forecasts in greater detail? We base a detailed discussion of the robustness of our results around this question. The discussion blends extensive econometric testing with a detailed assessment of how such tests relate to theory and practice of monetary frameworks. We offer three main explanations:

First, theory asserts the publication of forecasts will have a smaller impact on inflation when credibility is secured by other means, a prediction that is supported by the results in the paper. We do not detect a significant impact of transparency on inflation for those countries with inflation targets, and the effects are smaller for lower inflation countries whose credibility may be relatively strong.

Second, the result may have been biased by reverse causality, ie it is the attainment of low inflation that leads central banks to become more transparent, and not the other way round. Our statistical tests cannot completely reject such a possibility but demonstrate that it is unlikely to undermine the results. Furthermore, there are few if any examples of either (a) a framework in which policy-makers have reduced transparency in response to an increase in inflation, or (b) a transparent framework in which inflation has markedly increased.

Finally, we argue that many central banks have not yet completed the transition to greater transparency. The theoretical and empirical evidence on the effects of transparency is relatively new. And the practical precedents of frameworks in which published forecasts made important contributions to credibility-building emerged only in the 1990s.

In summary, we argue that the robustness tests have gone far enough to make us confident that we have identified empirically a channel for reducing and maintaining low inflation. Furthermore, there are global policy implications: there remain many central banks around the world that may achieve lower average inflation by publishing their forecasts in greater detail.