

Monetary Policy Transparency in Pakistan:

An Independent Analysis

by

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Introduction

- Rational expectations revolution
 - Lucas critique
 - Time inconsistency problem
- Solutions
 - CBI
 - Delegation
 - Contracts
 - Simple rules
 - Monetary policy transparency
 - TIP
 - Accountability of independent central bankers

What is transparency?

- Two types of definitions
 - Information symmetry
 - Effective communication
- “Transparency requires symmetric information between the monetary authority and the public” (Geraats 2002).
- “Transparency involves effective communication of the policy related information by the central bank to the general public or clarity of that information” (Winkler 2002).

Why Transparency?

- Political Benefits
 - Accountability of the independent central bankers
 - Public support for CBI and policies
 - Promotes public debate on certain issues
- Economic Benefits
 - Increased monetary policy predictability
 - Improved central bankers' performance (say forecast efficiency)

How much transparency?

- Complete transparency requires releasing information on each step in monetary policy. Specifically it involves information on the central bank's objective function, institutional arrangement of the central bank with the government, the macroeconomic forecasts, monetary policy strategy, decision making process, state of the economy, operational targets of the monetary policy and information on achieving these targets.
- However there is a trade-off between openness and the clarity of information released

Objectives of the Study

- To measure monetary policy transparency in Pakistan
- To compare actions by SBP in this regard to advanced central banks in the world.

Methodology

- Eijffinger and Geraats (2006) transparency index
- Five types of transparency, each with three questions
 - Political transparency
 - Economic transparency
 - Procedural transparency
 - Policy transparency
 - Operational transparency
- Equal weights
- Maximum score is 15

Different Types of Transparency

- Political transparency refers to the openness about monetary policy objectives, quantification of these objectives and the institutional setting between government and the central bank
- Economic transparency refers to releasing economic information that central bank uses for monetary policy. This includes information on current state of the economy (data on certain variables), the policy model used for policy analysis and the central bank's internal forecasts.
- Procedural transparency involves information on the explicit policy strategy and minutes and voting records of monetary policy committees' meetings
- Policy transparency relates to the openness of monetary policy decisions. It involves prompt announcement of policy decisions (on the day of implementation), an explanation of the policy decisions and disclosure of policy inclination or likely future actions.
- Operational transparency involves information on deviation of instrument from the operational target (control errors), contribution of monetary policy in achieving the final goals and unanticipated disturbances that may affect the transmission mechanism

Results – Political Transparency

■ **Formal objectives**

- Multiple objectives without clear prioritization
- Flip-flop policies

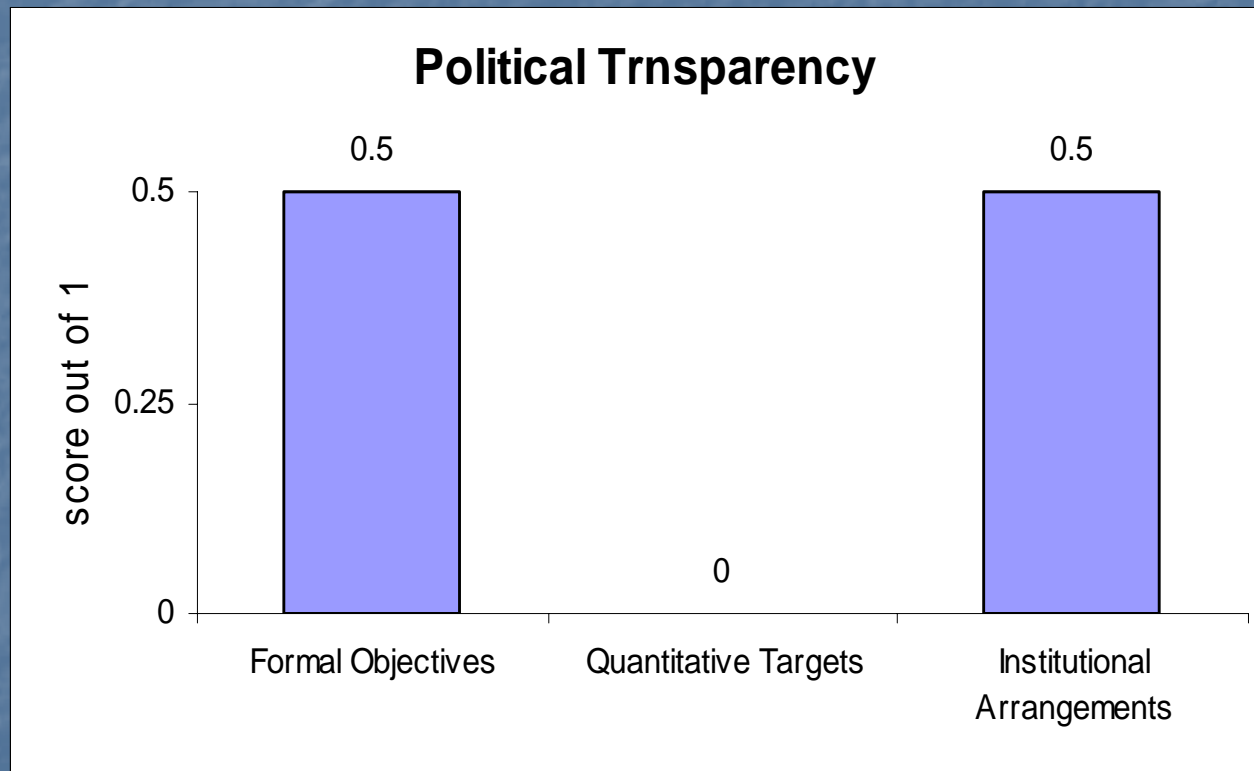
■ **Quantification of the Targets**

- Short term (one year) targets
- But not the medium term
- Projections as monetary lags greater than one year

■ **Institutional Arrangement**

- in February 1994, by making monetary policy sole responsibility of the SBP
- an ordinance in December 2000 makes government intervene in the SBP balance sheet
- the tenure of the SBP governor
- the independence is still partial in Pakistan (0.47) in 2004
- unexpected borrowing of government from the SBP and degree of monetization of fiscal deficit is uncertain

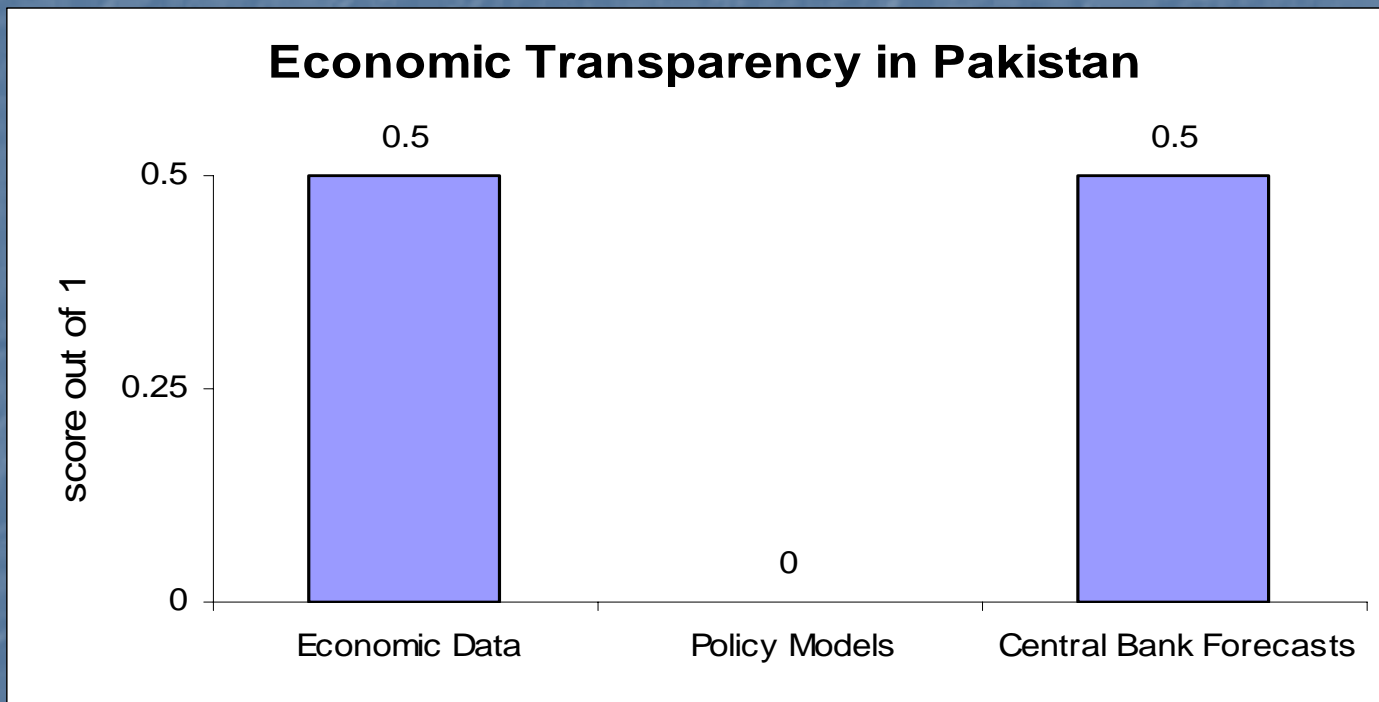
Results.....



Results – Economic Transparency

- **Economic Data**
 - Quarterly data on money supply and inflation but not available on unemployment, GDP and capacity utilization
- **Macroeconomic Model**
 - Question of existence
 - Any model used for forecasts
- **Central Bank's Internal Forecasts**
 - Short term forecasts for output and inflation
 - Not the medium-term forecasts
 - Forecast methodology
 - Rough projections and not the internal forecasts, as policy instrument path is missing – how to guess the CB commitment

Results.....



Results – Procedural Transparency

■ **Explicit Strategy**

- uncertainty about both the degree as well as the timings of the monetary authority's leaning against the wind
- Even monetary policy objectives are not explicit

■ **Minutes and Voting Records**

- No such tradition

Results – Policy Transparency

■ **Prompt Announcement of Operational Target**

- Prompt announcement of policy tools but not of the operational targets
- uncertainty regarding the operational target
- No private information on policy tools
- Target for M2 but not in the short run and frequent target miss

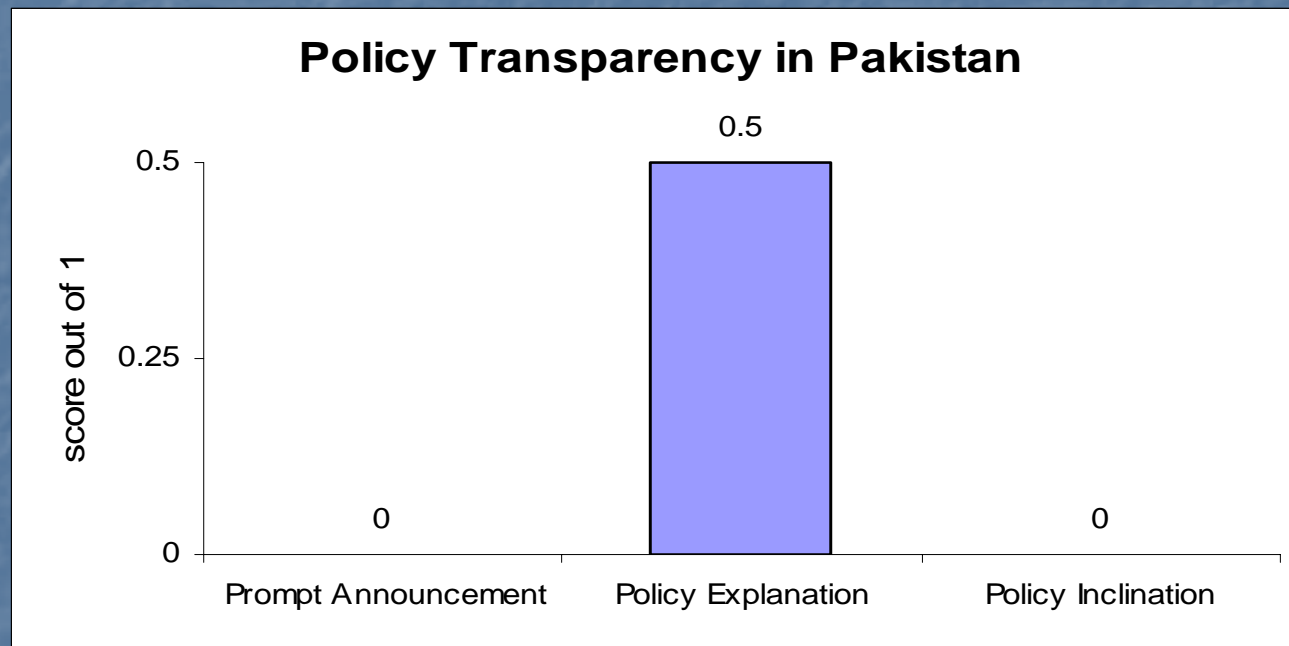
■ **Policy Explanation**

- Explanation of policy changes but not for all
- After a substantial lag (in reports)

■ **Policy Inclination**

- does not publish projection of the future policy rate
- the message on future policy actions is not much clear
- not explained after every policy meeting

Results.....



Results – Operational Transparency

■ Control Errors

- Explanation for target miss of M2 in reports
- also does some forecast analysis providing information on the likelihood of target achievement

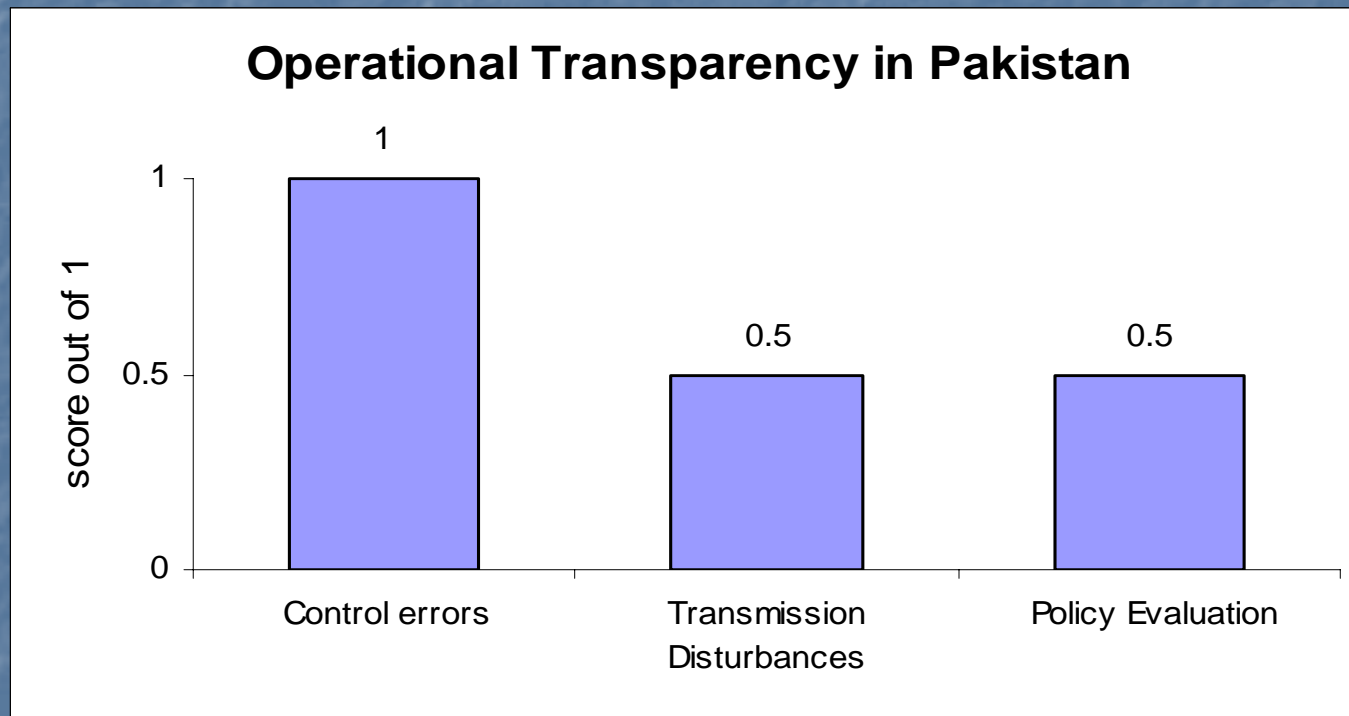
■ Transmission Disturbances

- only superficially without much explanation
- Information on expected target miss

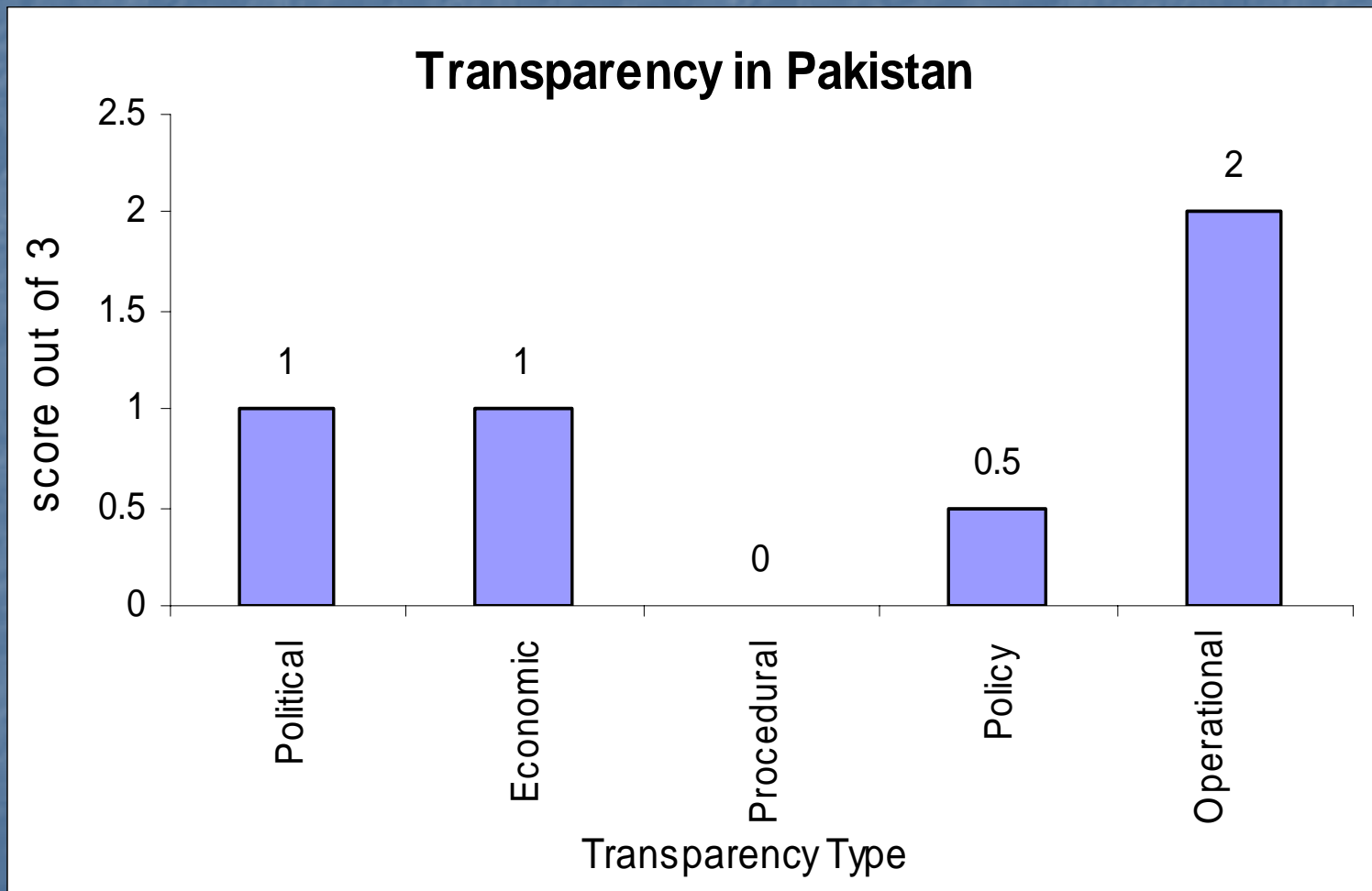
■ Policy Evaluation

- Superficial analysis and not the exact contribution

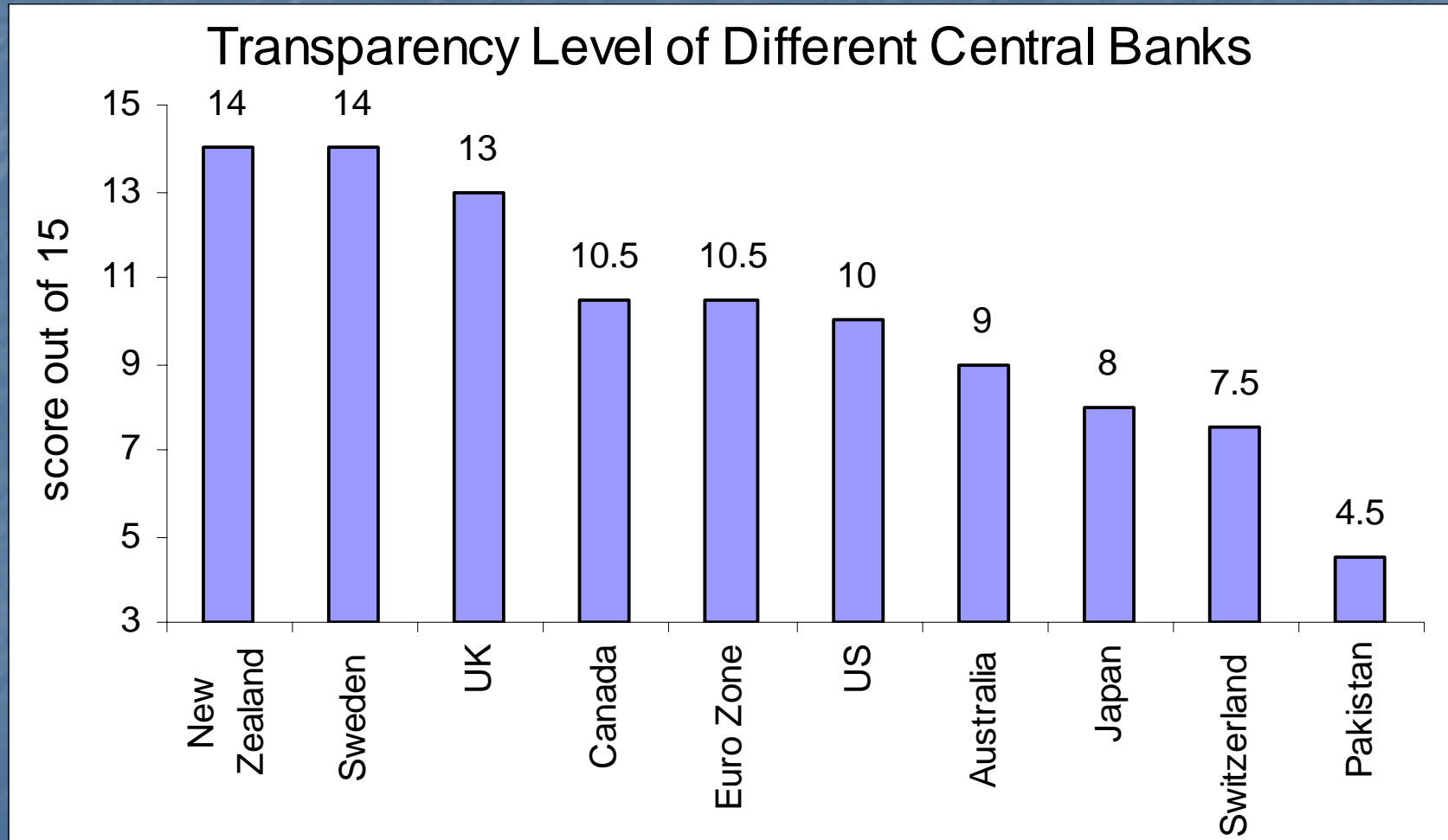
Results.....



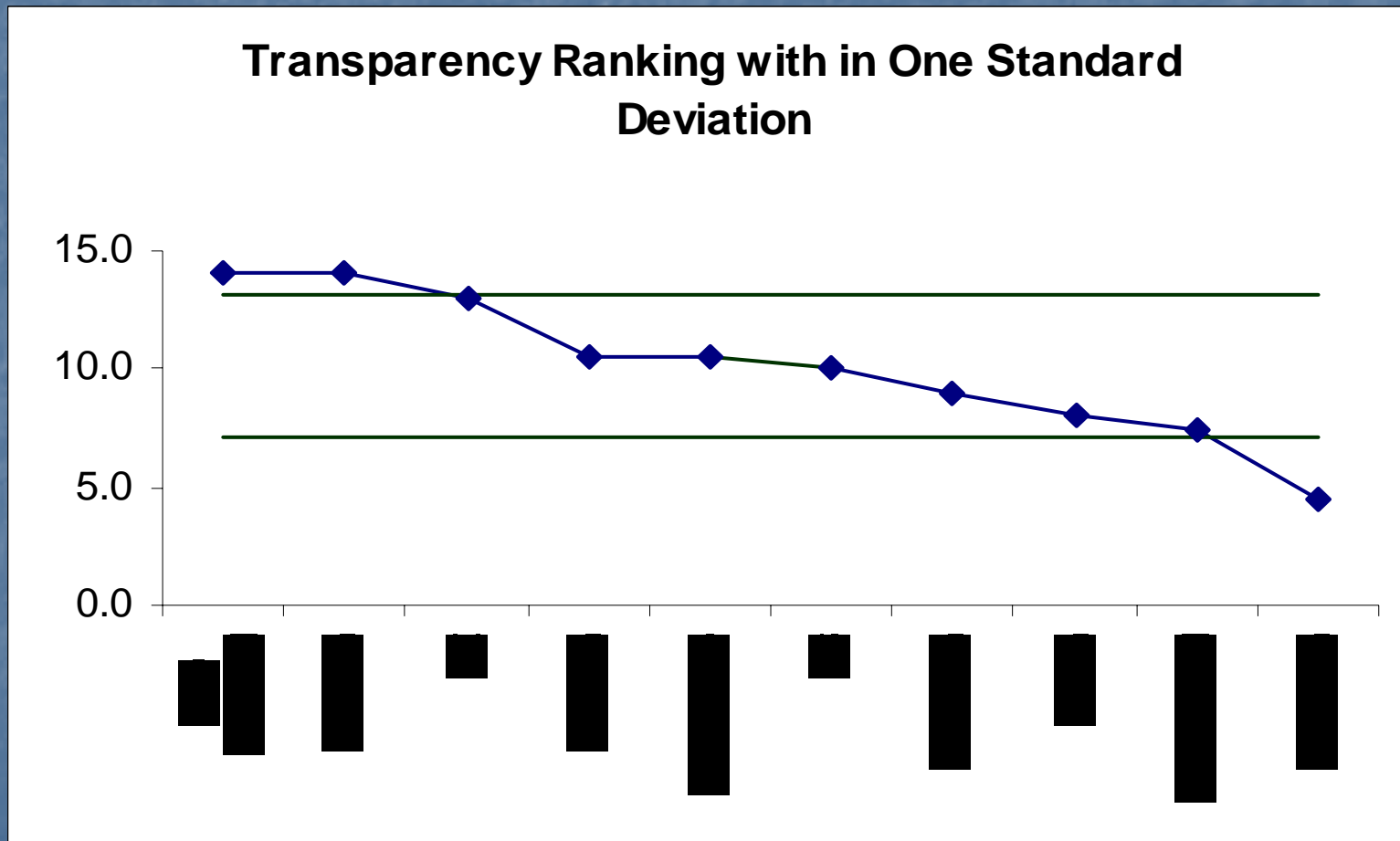
Overall Result



Comparison



An Analysis for Comparison



Thanks for your patience