Monetary Policy Communication in Malaysia

The Importance of Communication in Conducting Monetary Policy

Central banks can perform their roles and fulfill their goals more effectively when their policy actions and decisions are better understood by the public and financial markets. This has resulted in growing emphasis by central banks around the world to provide greater transparency to the public by expanding the modes of communication and increasing the frequency, amount and quality of information shared with external stakeholders. In this regard, Bank Negara Malaysia has in the recent years published more information and provided more detailed explanations on the Bank's role, policy objectives, as well as the assessment and rationale underlying its monetary policy decisions.

One of the key reasons for the importance of monetary policy communication is the recognition of the need to effectively manage expectations. By managing expectations about the future course of economic activity and inflation, central banks can influence aggregate demand in the immediate future given the forward looking nature of economic agents. Importantly, expectations of future prices are a key factor in determining actual inflation. When people expect prices to rise rapidly in the future, they react by bringing forward purchases of goods and services, which lead to the increase in the prices for these goods and services, or demand higher wages, thereby creating the very inflation they had earlier expected. Communications on the Bank's commitment and strategies to ensure price stability is therefore important for promoting greater public understanding and confidence that long-term inflation would remain low, and hence encourage agents to react accordingly. While good communication is not a substitute for good policy making, central banks need to ensure good policy decisions are supported by strategic communication efforts, which are also reinforced by a track record of consistent policy decisions to ensure the predictability, credibility and effectiveness of monetary policy.

Clear communication is also important for the efficient transmission of monetary policy to the economy, for example through the interest rate channel. Under the New Interest Rate Framework adopted in April 2004, the Bank seeks to influence the overnight market interest rate to be at the desired level of the Overnight Policy Rate (OPR). Adjustments to the OPR alone may not be sufficient for monetary policy to be effective in influencing aggregate domestic demand given the long and variable lags between the time the policy rate is changed and when it actually affects spending and investment decisions by economic agents. Rather, it is important for the market to respond to the signals of the Bank's current and expected monetary policy stance through the OPR, and appropriately adjust the prices of relevant financial assets, which in turn affect spending and investment decisions by economic agents. In the money market, this involves adjustments to other maturities and instruments such as interest rate swaps that influence the cost of funds, which subsequently form the basis of the retail lending rates charged to bank borrowers. In the bond market, expectations of the future path of interest rates affect the cost of raising funds to firms. Effective communication therefore also facilitates a more rapid transmission of the policy rate into the pricing of credit and longer-term rates, thereby enhancing the overall efficiency of the monetary transmission mechanism.

Given the significant impact of policy actions by the central bank on the economy through its influence on aggregate domestic demand, central banks find it necessary to provide an explanation of their decisions and the rationale underlying these decisions. Greater transparency by central banks thus enables a more objective assessment of the central bank's performance by external stakeholders. Furthermore, public discourse on policy matters can lead to improvements in internal deliberations and promote the formulation of more effective policies. Through greater engagement, the Bank also aims to receive feedback from the industry, economic sectors, the market and the public, and provide an enhanced understanding of the central bank's reasoning, strategies and objectives.

There continues to be divergent views and differing practices on the appropriate degree of transparency and what constitutes an ``optimal" communication strategy. This can mainly be attributed to, among others, the differences in the decision-making structures, policy frameworks, as well as the institutional environment in which a central bank operates. For example, an inflation targeting central bank would tailor its monetary policy communication strategy with respect to an explicit numerical target for inflation. In the case of Bank Negara Malaysia, while price stability is a primary objective, promoting sustainable growth and financial stability are also important policy objectives. For a central bank with multiple mandates, the pursuit of monetary policy which is consistent with the other mandates places greater emphasis on elucidating the assessment on the balance of risks to both growth and inflation whenever a policy decision is made. By fostering a better understanding among its stakeholders on the Bank's assessments of economic and financial developments and the policy initiatives, effective communication facilitates the successful transmission and acceptance of the Bank's policies. Accordingly, the Bank employs several channels for its communication.

Channels for Monetary Policy Communication

The Monetary Policy Statement (MPS) is the main channel for monetary policy communication for the Bank. The MPS not only states the monetary policy decision, but also provides the Bank's assessment of the performance of the economy, inflation and the policy issues. The first MPS was issued on 27 August 2003 and was initially released only on a quarterly basis to coincide with the announcement of the GDP growth figures. Since 2006, the MPS is issued after each Monetary Policy Committee meeting. The publication of more regular and timely information on monetary policy decisions is part of the Bank's on-going initiative to enhance a greater understanding of the country's economic and financial conditions, and that has become a factor affecting the formation of market and public expectations. The Bank also releases in advance the schedule of MPC meetings for the following year[1]. The transparency of procedures and the clarity of monetary policy decisions to market participants have contributed towards facilitating orderly market adjustments following monetary policy announcements.

Bank Negara Malaysia also publishes regular reports that are readily available and widely disseminated to the public. In March each year, the Bank publishes its Annual Report. In addition to being an account of economic developments that took place during the previous year, the Annual Report includes the Bank's forecast for economic growth and inflation, as well as the monetary policy outlook, in order to provide the public with a comprehensive assessment on the balance of risks to economic growth and price stability for the year. The forecasts are subject to rigorous assessments within the Bank prior to publication, and are subsequently assessed regularly in light of new developments. Any revision to these forecasts will most likely be communicated either through the MPS or during the quarterly press conferences held in conjunction with the release of the quarterly GDP growth figures.

The Quarterly Bulletin provides a quarterly record of economic and financial developments, while the Monthly Statistical Bulletin provides timely and comprehensive statistics on the economy and financial system. To reduce the time lag of data releases and to increase the accessibility of information, the dissemination of these reports also takes place electronically through the Bank's website (URL: http://www.bnm.gov.my).

[1]The advance schedule is normally released in conjunction with the final MPS in the preceding year.

Other important communication channels include public comments by the Governor through media interviews and speeches at public forums, which are accessible on the Bank's website. Press conferences during the release of the Annual Report and Quarterly Bulletins, as well as briefings to investors, analysts and economists, are also key communication channels for the Bank to engage with the public and participants of the financial market. In addition, the Bank conducts regular meetings, briefings and consultations with financial market participants, industry and business associations in order to engage them on economic and financial issues and policies.

Challenges in the Communication of Monetary Policy

For it to be effective, the communication of monetary policy matters needs to strike a balance between comprehensiveness, relevance and timeliness. The fact that the monetary policy horizons extend to the medium term means central banks need to undertake an array of quantitative and qualitative analyses to form their assessment about the growth and inflation outlook as well as the risks involved. As with any prediction about the future, such assessments are often wrought with uncertainty, and hinge crucially on the underlying assumptions regarding a range of factors. For example, forecasting the global price of oil in 2007 and 2008 amid a rapidly changing global financial and economic environment was a highly challenging exercise. In such a volatile environment, it would be necessary to update the forecasts more frequently. It is also important to explain to the public that any inflation forecast is not a monetary policy target, but that it could potentially involve a change in monetary policy.

While monetary data and indicators are widely available and extensively analysed by market participants and analysts, it is nevertheless still important for the central bank to provide market participants with its perspective on the latest developments. In some circumstances, such communication would confirm market beliefs, while at others, the central banks' perspective provides market participants with further assessments of the more recent developments.

The communication challenges clearly manifested themselves in the volatile environment during 2007 and 2008, evidenced by the keen debates on whether monetary policy in Malaysia ought to be tightened in response to high and rising inflation. On both occasions, the Bank explained in great length its rationale for not raising the OPR, which was contrary to the expectations of several market participants. Specifically, in the first half of 2008, the upward inflationary pressures on global economies, including Malaysia, were caused by supply-driven factors, namely the higher global food and commodity prices. In communicating the decision for the Bank's monetary policy stance to remain unchanged, emphasis was placed on explaining the diagnosis of the situation and why a monetary response was not required. It was explained that, first, as a demand management tool, the role of monetary policy in a supply-driven shock was fairly limited. Secondly, the assessment was for the pressure on inflation to be temporary since the factors that could create second-round effects of price increases were absent or weak. Third, the Bank highlighted the high possibility of an oncoming weakness of the economy that would exert a moderating impact on inflation going forward. Although the prognosis turned out to be correct, for several weeks, policy communication faced considerable challenges. It was only when actual signs of weakness in the global and domestic economies began to appear that there was a convergence of market views with that of the Bank.

Communication on monetary policy decisions and related issues is an on-going challenge. Effective central bank communication, nevertheless, would remain an integral part of the Bank's role in conducting monetary policy. Going forward, the Bank will continue its focus on improving its channels of communication, and on enhancing the availability of relevant information on the monetary policy decision-making process and outcomes.