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# Central bank transparency and financial market expectations: The case of emerging markets



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### ABSTRACT

In this paper, we study how central bank transparency influences the formation of money market expectations in emerging markets. The sample covers 25 countries for the period from January 1998 to December 2009. We find, first, that transparency reduces the bias (the difference between the money market rate and the weighted expected target rate over the contract period) in money market expectations. The effect is larger for countries with no exchange rate peg and countries with low income. Second, an intermediate level of transparency is found to have the most favorable influence on money market expectations: neither complete secrecy nor complete transparency is optimal. Finally, all subcategories of the [Eijffinger and Geraats \(2006\)](#) index lead to a smaller bias in expectations, with political transparency having the largest effect.

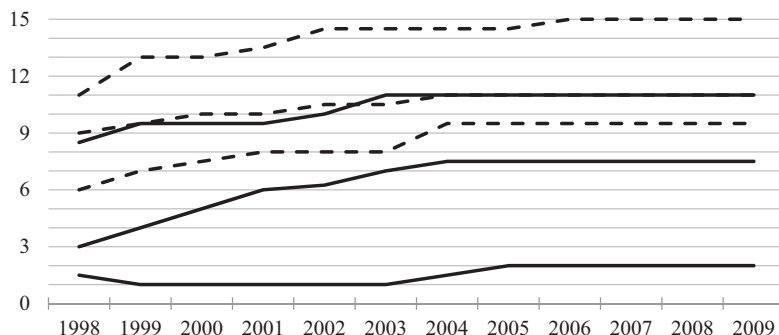
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## 1. Introduction

Over the past two decades, central banks have expended a great deal of effort on increasing their transparency. Central bank objectives and goals have been specified and quantified, macroeconomic forecasts are published, interest rate decisions are announced and explained immediately, and some central banks provide indications of the likely course of monetary policy in the near future. Consequently, there is a vast empirical literature on central bank transparency, most of which finds

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**Fig. 1.** Transparency index for 25 emerging markets and nine advanced economies.

beneficial effects of such transparency. For example, [van der Cruijssen and Eijffinger \(2010\)](#) review the literature and conclude that transparency (i) improves consensus across forecasters, (ii) lowers inflation and anchors inflation expectations, (iii) improves the credibility, reputation, and flexibility of central banks, (iv) has no obvious influence on output and output variability, and (v) improves policy anticipation.<sup>1</sup> Most of this literature focuses on mature economies, but central banks in emerging markets have also been hard at work increasing their transparency.

[Fig. 1](#) shows the minimum, median, and maximum transparency index for the 25 emerging markets in our sample<sup>2</sup> versus nine often studied advanced economies.<sup>3</sup> Transparency is higher in advanced economies, but there is a noticeable trend of increasing transparency in emerging markets during the first half of the sample period (1998–2003). However, in the second half of the sample period (2004–2009), there is no change in minimum, median, and maximum transparency of the emerging markets. [Siklos \(2011\)](#) concludes that it is unclear whether this break reflects limits to central bank transparency or, to some extent, transparency “fatigue.” Regardless of the reason for it, in the empirical analysis below, we explicitly control for this break.

Despite these developments in the late 1990s and early 2000s, empirical evidence about the influence of central bank transparency on emerging markets is scant. [Fatas et al. \(2007\)](#) analyze the effects of a formal quantitative monetary policy target (exchange rate target, money growth target, inflation target) in 42 advanced and emerging countries over the period 1960–2000. They find that a de jure target tends to lower inflation and smooth business cycles and that hitting the target de facto increases the positive effects. [Chortareas et al. \(2002a\)](#) construct a transparency index based on forecasts from 87 central banks worldwide covering the period 1995–1999. These authors find that greater transparency in forecasts is associated with lower inflation for countries with an inflation target or a monetary target, but not for countries with an exchange rate anchor. Output variability is unaffected. In addition, [Chortareas et al. \(2002b\)](#) examine the influence of transparency in forecasting and decision-making on the costs of disinflation. The sacrifice ratio is negatively related to transparency in forecasting but not to transparency in the decision-making process.

[Dincer and Eichengreen \(2009\)](#) construct a broader index of transparency for 100 central banks and document a significant movement toward higher transparency during their sample period (1998–2006). Using transparency as an explanatory variable, they find that higher transparency is associated with less inflation variability. However, inflation persistence is not significantly affected by this trend. [van der Cruijssen et al. \(2010\)](#) employ an index based on the same questionnaire but arrive at a

<sup>1</sup> A more detailed and formal overview of the empirical results can be found in [van der Cruijssen \(2008, 30\)](#).

<sup>2</sup> The sample countries are: Argentina, Brazil, Bulgaria, Chile, Colombia, the Czech Republic, Hong Kong, Hungary, India, Indonesia, Jordan, Korea, Kuwait, Latvia, Lithuania, Pakistan, Peru, Philippines, Poland, Romania, Russia, Singapore, South Africa, Thailand, and Turkey. The sample selection is explained in the next section.

<sup>3</sup> Australia, Canada, the European Monetary Union, Japan, New Zealand, Sweden, Switzerland, the United Kingdom, and the United States.

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