



Central bank transparency and credibility: The case of Poland, 1998–2004

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Abstract

In this study we analyse transparency and credibility of the National Bank of Poland's monetary policy under the inflation-targeting regime in the period 1998–2004. To verify NBP transparency we analyse the transparency of the monetary policy framework and the predictability of policy decisions. With respect to the former, we present some indicators suggested in the literature, while with respect to the latter we analyse the formation of interest rate expectations by commercial bank analysts. As far as NBP credibility is concerned, we evaluate the way in which inflation expectations of consumers and commercial bank analysts are formed and how they are related to the inflation target.

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1. Introduction

A central bank is credible if the public believes that the monetary authority will do what it says (Blinder, 2000). In the context of inflation targeting (IT) strategy this may be verified by analysing the gap between inflation expectations of economic agents and the central bank inflation target or forecast. Theoretical literature and empirical evidence show that transparency is essential for establishing central bank credibility. Transparency is a multidimensional phenomenon, which involves not only the issue of releasing adequate, in terms of its quantity and quality, information by the central bank, but also correct interpretation of the released

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information by the public. In this sense, transparency should enhance the ability of the private sector to predict monetary policy actions.

The aim of our study is to test the transparency and credibility of the National Bank of Poland's (NBP) monetary policy in the years 1998–2004, as conducted under the inflation-targeting regime. In particular, we examine whether the inflation-targeting framework and the progress that the central bank has made with respect to communication with the public have helped private sector agents predict monetary policy actions and align their expectations with the inflation target. We use survey-based measures of inflation expectations of commercial bank analysts and consumers as well as survey data on commercial bank analysts' interest rate predictions. To verify monetary policy transparency we separately inspect its two dimensions, namely, the transparency of monetary policy framework and of monetary policy decisions. With respect to the former, we present some transparency indicators as suggested in the literature and make cross-country comparisons, while with respect to the latter we analyse in detail the formation of interest rate expectations by commercial bank analysts. As far as monetary policy credibility is concerned, we focus our study on the way in which inflation expectations of consumers and commercial bank analysts are formed and how they are related to the NBP inflation target.

The results of our analysis lead to some puzzling conclusions on the effectiveness of inflation targeting in Poland in shaping expectations of the private sector. Even though transparency of the monetary policy framework in Poland, assessed by the quantity of information shared by the central bank with the public, seems to be relatively high, the predictability of interest rate decisions is weak and there are no signs of improvement in terms of macroeconomic efficiency of interest rate expectations. Despite persistent deviations from the target, the NBP inflation target constitutes an important information variable taken into account by commercial bank analysts. On the other hand, Polish consumers do not pay attention to the inflation target while forming their expectations regarding the future movements of prices. Monetary policy is not credible among consumers.

This paper is organised as follows: Section 2 contains theoretical considerations on the relationship between central bank transparency and credibility, and summarizes the experience of inflation targeters in building transparency and credibility. In Section 3 we briefly describe the Polish experience with the IT strategy and verify the credibility of the NBP inflation targets, focusing on inflation expectations formed by consumers and commercial bank analysts. Section 4 tests the transparency of the NBP monetary policy framework and the predictability of interest rate decisions. The final section offers our conclusions.

2. Central bank credibility and transparency — theoretical aspects

There is a common agreement in the literature on monetary economics that private-sector inflation expectations constitute an important variable in the conduct of monetary policy. A central bank that can manage expectations of the private sector should be able to conduct monetary policy more effectively. Such a central bank is deemed credible. Thus, the concept of central bank credibility refers directly to private-sector expectations. [Blinder \(2000\)](#) provides a very short and intuitive, yet in our view most accurate, definition of credibility: “a central bank is credible if people believe it will do what it says”. This is in line with the concept of [Cukierman and Meltzer \(1986\)](#), who define credibility as “the absolute value of the difference between policymakers' plans and the public's beliefs about those plans”.

Although the central bank's credibility is relatively easy to define, it is difficult to measure. There is no commonly accepted and used indicator of monetary policy credibility. Many of the

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