Discussion

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In recent years, there has been growing recognition of the importance of communications to the effectiveness of monetary policy. This recognition is tightly linked to a number of factors but, I would argue, it is linked most importantly to the rising popularity of inflation targeting as a framework for monetary policy and the increased understanding of the importance of having well-anchored inflation expectations.

These linkages are not difficult to understand. Inflation-targeting central banks have a clearly defined objective for monetary policy. In most cases, these central banks have also been delegated responsibility for the conduct of monetary policy, and so are held accountable for achieving the policy objective. Accountability requires that a central bank be able to clearly communicate its actions and the rationale for them. Indeed, when the objective is an explicit target for the annual rate of inflation, elected officials and the general public are able to have a good idea of how successful the authorities are in carrying out policy.

As we have heard from Governor Ortiz, inflation targeting has become as popular among emerging-market economies as industrial economies. A key reason for this popularity is precisely the ability of an inflation-targeting central bank to promote clarity of objective—clarity about what monetary policy can, in fact, deliver. For clarity of objective to translate to increased central bank credibility, however, depends on the ability of the central bank to meet its target and, equally importantly, to communicate its policy effectively—one of the key challenges Governor Ortiz identified in his presentation.

More broadly, as central banks have gained experience with inflation targeting, they have found that good communications can be a tremendous asset in terms of anchoring inflation expectations. As Carl Walsh (2008) has recently suggested, the success of inflation targeting is, in part, due to its modesty—modesty in terms of its focus on the importance of anchoring inflation expectations. One lesson that this focus of inflation targeting has taught us, Walsh concludes, is that transparency and communications are critical for any successful monetary policy. Indeed, the considerable macroeconomic benefits that flow from well-anchored inflation expectations underscore the importance of good central bank communications. Put another way, as we have said in our speeches too many times to count, monetary policy works better when people understand what the central bank is doing, and why (Jenkins 2004).

But while inflation targeting has promoted the importance of good communications for a central bank, it has also made the task easier by providing a way of organizing the various forms of communications that a central bank undertakes. Since the policy goal is transparent and readily understood, a central bank can focus on explaining the paradigm it follows and how it undertakes the analysis required to make its decisions. In essence, the framework becomes the communications strategy and because of this, the markets, the public, and elected officials can all better understand not just our policy goal, but why we are making the decisions that we do to achieve that goal.

A review of the Bank of Canada's many actions over the past two decades that have served to increase the importance of communications will illustrate the point. Beginning with the declaration of former Governor John Crow in 1988 that price stability should be the target of the Bank of Canada's monetary policy (Crow 1988), we have taken a series of important steps that have confirmed the growing importance of communications. In 1991, we entered into a joint agreement with the federal government that made public and concrete our inflation target. Subsequently, we moved to a system of having a target for the overnight rate of interest be our policy rate, as opposed to a policy rate that fluctuated with the result of regular T-bill auctions. We established the practice of issuing press releases when we adjusted our overnight rate target and, in 1995, we introduced our *Monetary Policy Reports* to present our analysis and explain how our actions were designed to achieve our target. From there, we moved in 2000 to a system where we established eight days a year on which we would commit to make announcements about interest rates, whether or not we adjusted policy.

This was the infrastructure in place here at the Bank when David Dodge arrived in 2001. The emphasis on communications continued, as David constantly looked for ways to enhance the institution's transparency and make our actions more understandable to markets, politicians, reporters, and the public. In 2002, we published an article (Macklem 2002) in the *Bank of Canada Review* that outlined our decision-making process, describing in detail the inputs and analytic processes we use to reach a decision. In that same year, David used a number of speeches to emphasize the importance of communications. "With our press releases, periodic reports, and speeches, we try to explain our thinking. In doing so, we hope to help Canadians, including those in the financial markets, anticipate the general direction of monetary policy," he said (Dodge 2002). To ensure clarity of message and minimize the risk of misunderstanding, the gap between our interest rate announcement and the publication of the related *Monetary Policy Report* or *Update*—which contains the detailed rationale for the previous decision—was shrunk from two weeks to one week to two days. In sum, under David's leadership, communications became increasingly focused on our paradigm, or framework. It also became an integral part of the process, something to think about before decisions were made, not an afterthought.

While the Bank as an institution made further important strides in communications under David's leadership, it was the communications style he brought to the position—described as plain-spoken or straight-talking—that was a hallmark of his term. I thought that I should recall just a few examples, so that we can all appreciate David's unique contributions to central banking communications.

David understood that monetary policy truly does work better when it is understood, so, often he would make sure to express things in ways most people could understand. After telling reporters that monetary policy would need to be tighter, David added, "In other words, we will need to raise interest rates."

In illustrating the intricacies of the monetary policy transmission mechanism, David noted, "We could really ram up interest rates and that would shorten the period over which inflation will come back to target. . . ."

For any inflation targeter, the role of the exchange rate can be difficult to communicate, and David usually tried to avoid this minefield. I can recall, however, one occasion in 2003 when David broke with tradition. Asked after a speech in Ottawa about the future path of the dollar, he said he normally didn't talk about such things, but this time he was prepared to make an exception. "The dollar is either going up," he predicted, "or it's going down, or it's going to stay at the same level."

Of course, displays of David's communications style were not restricted to discussions of the inflation-targeting framework. In detailing the finer points of globalization to the members of the House of Commons Finance Committee, David explained, "the very badly paid Chinese worker is now subsidizing me when I go to buy my blue suit."

Finally, I would note that while David was always open and transparent in his communications regarding our framework, he was less so in terms of discussing his own future. "I'm going to take six or seven months to figure out what I want to do when I grow up," he said upon leaving, and departed with this piece of advice for himself: "I think the one really important thing for an outgoing governor is to keep his or her mouth shut."

Another hallmark of David's term as Governor was his insistence on top-quality research directed to critical policy issues. A clear expression of this can be found in the Bank's background document published in November 2006 at the time of the last five-year renewal of our inflation-control target with the government (Bank of Canada 2006). In that document, two long-standing, but as yet unanswered, questions were posed:

(i) Is 2 per cent the optimum inflation target, or should it be lower?

(ii) Would price-level targeting be better than inflation targeting?

By posing these questions with a timeline to complete the research well before 2011, sufficient time was built in for open discussion of the results and their implications. Too often in the past this was not the case. As well, we have been successful in engaging academic and central bank researchers on these important questions.

Let me conclude with another quote from David, this one from his closing statement during his final appearance before the Senate Committee on Banking, Trade and Commerce on 6 December 2007. This statement clearly articulates his commitment to price stability and to the importance of staying at the forefront of monetary policy thinking.

". . . we have learned, again very painfully, that maintaining people's confidence in the future value of money is important. . . . The Bank and the government have to examine that, whether the precise details are right, the basic thrust [of our inflation-targeting regime] is absolutely right, so that Canadians can go about their daily lives with confidence that their savings will not be expropriated by inflation at some time in the future."

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