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Central bank transparency and the consensus forecast: What does The Economist poll of forecasters tell us?

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ABSTRACT

We are interested, in this paper, in studying the effects that central bhat transparency is a prerequisite for accanks exert on private sector forecasts by means of their transparency and communication measures. We analyze the impact of central bank transparency on the accuracy of the consensus forecasts (usually calculated as the mean or the median of the forecasts from a panel of individual forecasters) for a series of macroeconomic variables: inflation, Real output growth and the current account as a share of GDP for 7 advanced economies. Interestingly, while it is found of significance of central bank transparency and communication measures on forecasts themselves, there appear some limits of the same measures when we study their impact on forecast errors. Our findings, indeed, suggest that deviations of the economic forecast data from the realized ones (RGDP and the current account as a share of GDP) are a bit affected by the central bank transparency measures considered in the paper. Inflation forecast errors, especially, are not affected at all by those measures. A possible explanation (among others) could be attributed to the inefficiency of the mean forecasts. Inefficiency of the consensus forecasts is not a new issue from a theoretical point of view, but its empirical relevance is for the first time (to our knowledge) questioned on data extracted from the Economist poll of forecasters. More particularly, our paper extracts practical implications over the effectiveness of transparent announcements in forecast formation process. We rely on two noisy information models, though having different mechanisms (Kim et al., 2001; Morris and Shin, 2002) both of which are consistent with overweighting issue to explain the inefficiency of the consensus forecast.

1. Introduction

Nowadays, transparency practices are seen as a successful premise in achieving the objectives, especially those applied in monetary policy framework. The prompted rise of central bank transparency is derived from the view that transparency is a prerequisite for accountability in an era of independence (Dincer and Eichengreen, 2014).

We address an empirical focus on the effects that central banks exert on private sector forecasts by means of their transparency and communication measures.

The central bank's public disclosure about monetary policy and regular assessment of economic developments attracts market participants. This is helpful for the markets to understand how systematic, the response of monetary policy to economic development and shocks, and to anticipate the overall stance of monetary policy over the medium term. Markets can thus develop more efficient and accurate forecasts, thereby allowing for a quick implementation of monetary policy in financial variables. In recent years, central banks around the world have increased the volume of information they offer to

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the public. For example, many central banks have become more explicit about the long-run objectives of monetary policy such as long-run inflation objectives. Central bank transparency is warranted because such a practice generates important benefits including more effective monetary policy (Sellon, 2008). Markets don't only react to central bank's announcements because they are valuable, but also because other markets participants will react to the same disclosure. However, public disclosure may serve as a "double-edge" sword and could lead to inefficient outcomes (Morris and Shin, 2002).

In this paper, we use rarely exploited data[1] contained in the Economist poll of forecasters and investigate whether, or to what extent central bank communication and increased transparency have affected both the level and the accuracy of private agents' forecasts of inflation and other economic variables. There exists an extensive literature on forecasts, forecast accuracy, and their response to central bank's policies. Bauer et al. (2006) looked at the effects of changes in Fed's communication policy on macroeconomic forecasts taken from Blue Ship Economic Indicators report and found that the publication of FOMC statements in addition to the Fed's rate decisions didn't reduce the forecast errors. In the same context, Hubert (2013) examined the usefulness of information contained in FOMC macroeconomic forecasts (central bank's forecasts) using data from the Survey of Professional Forecasters (SPF). Another strand of the literature is closer to our framework. It assessed the effect of increased central bank communication and transparency on private expectations.[2] Capistran and Ramos-Francia (2010) and Gürkaynak et al. (2010), among others, studied the effect of inflation targeting on private forecasts. Most of the previous papers concentrate either on a specific component of central bank's communication and transparency policy (for example the adoption of inflation targeting regime taken as a variable of interest) or they consider the dispersion of inflation expectations as the response variable. We contribute to the existing literature by, first, evaluating the impact of central bank's practices on forecasts both in terms of level and accuracy. The second aim of the paper is to discuss the (in)efficiency issue of the consensus forecast as a proxy of private-sector's expectations. The associated test is carried out by calculating the forecast revisions and their correlation with the forecast errors.

We are aware of two papers of Siklos (2003, 2010) exploring data from the Economist poll of forecasters. We deviate, however, from his approach in, at least, five main aspects:

1. Siklos (2003, 2010) focused mainly on inflation[3] in level and inflation forecast disagreement, while our study addresses the consensus forecast and covers other key economic indicators. More importantly, the current account as a share of GDP is rarely discussed in forecasting literature.
2. We include a set of controls susceptible to affect the forecasts. We fill this gap by including the appropriate determinants to predict future inflation, RGDP and the current account as a share of GDP besides the variables of interest[4];
3. We extend the analysis to include more transparency and communication variables. Precisely, we use the multidimensional index of transparency[5] constructed by Dincer and Eichengreen (2010, 2014).
4. It is worth exploring whether increased transparency and communication levels influence private sector process formation. It is, also, of utter importance to test how the forecast accuracy is affected as we need to make sure that most transparent central banks ensure lower levels of forecast errors.
5. We contribute to the literature on the forecast efficiency by seeing how aggregating all the monthly incoming information by the forecasters is a challenging task.

We believe our study could interest both policy makers and researchers as it offers further insights on how effective the central bank transparency and communication are in improving the accuracy of the private sector expectations. The beliefs that the private sector forms about the central bank's announcements in forecasting are important because they determine ultimately the inflation and the output, outcomes, even though those forecasts don't match the central bank's policy rule.

The remainder of the paper is as follows; Section 2 presents the theoretical basis of our framework, Section 3 describes the empirical analysis, including description of data used and presents the main results of estimations. Section 4 offers further interpretations of those results. Section 5 concludes.

2. Theoretical deliberations

Before analyzing data, we present an illustrative (and simple) framework that motivates our empirical analysis. Prior research on accuracy and consensus forecasts' efficiency showed that forecasters use both public (common) and private information in forming predictions. Therefore, if these forecasts are efficient, they will incorporate all available information. In a model where analysts possess this information in the form of noisy signals about the analysts' beliefs, these beliefs diverge. The problem arises from two possible facts. (i) either the forecasters take into account irrelevant information (ii) or they underweight the private information. The main result referred the phenomenon to as "inefficiency of the mean forecast". Morris and Shin (2002) considered the same data-generating process described above, but added a beauty contest

[1] Most of the related papers use data from Consensus Economics, Blue ship Indicators, Survey of Professional Forecasters, Wall Street Journal. . ., etc
[2] We take a look further at some papers in the empirical analysis (see Section 3).
[3] Inflation and GDP are the most variables subject to analysis in previous studies.
[4] We mean central bank transparency and communication variables.
[5] For instance, Siklos (2010) found that transparency increases the inflation forecast disagreement in a cross-country study of 9 economies