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Communicating in Markets: Is it worthy to be wordy?

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Much has been said about the state of financial markets and how to contain a financial crisis since the Lehman Brothers crisis in 2008 sent the global economy on a downward spiral that it is still struggling to recover from.

In the midst of on-going discussions around complex financial concepts, it is perhaps time to step back and look at the importance of communication, said David G Fernandez, head of JP Morgan's Emerging Asia Research team, at the Sim Kee Boon Institute for Financial Economics (SKBI)

Annual Conference. He notes the importance for policy makers to communicate with market participants in light of the increase in volatility and tail risks in financial markets.

The conference focussed on the issues of global inflation, how the asset bubble had developed in various markets and its potential impact on the economy, and the effectiveness of various macro-prudential policies to control inflation and asset bubbles.

There are over 30 measures of macro-prudential tools that are used by central banks and regulators, according to an International Monetary Fund survey. But there is a lack of consensus as to which organisation in each country should have the authority and accountability to implement macro-prudential policy, and the amount of discretion over such policy that such institutions should have.
With markets not knowing who to look to or even what to look for, regulators need to consider their communication strategy carefully, to avoid fuelling uncertainty in the markets. Fernandez, who was an economist in the Council of Economic Advisers during President George Bush's administration, cited the central bank, Bank Negara Malaysia as a positive example of a financial institution that clearly distinguishes monetary tools from prudential tools.

Fernandez analysed the content of monetary policy documents from the central banks of emerging Asian economies for information that could help markets determine policy decisions. His study included Korea, Thailand, the Philippines, Taiwan, Indonesia, Malaysia, India and Singapore. The United States, New Zealand and Japan were used as benchmarks.

The 1,186 documents studied included policy statements, press and tele-conferences, and speeches. Fernandez observed that the Indian central bank was the most verbose in its monetary policy statements, with an average word count of 3,087, compared to terser statements from the US Federal Reserve, which had only 265 words on average. Singapore was the second most wordy, at 774 words.

Over time, certain central banks have become more concise, with the Reserve Bank of India's statements decreasing from 10,000 words to 2,000 in 2010. However, the Bank of Korea has increased its word count from 200 words in 1998 to 350 words in 2010.

Fernandez also scored the respective bank's documents according to forward-looking content on its outlook and risks for growth, inflation, guidance on future monetary policy actions and reviews of current economic conditions.
He found the proportion of forward looking content varied greatly with the benchmark countries scoring highest. Japan led with a score of 10.54 out of a maximum score of 14. India was highest among emerging Asian countries with 8.21 and Singapore and Taiwan were both comparatively low with respective scores of 6.18 and 6.30.

Comparing this with consensus forecast error, Taiwan topped the charts with 38 per cent of its forecasts being off the mark. Again benchmark countries scored well as Japan's error rate was only five per cent and the US eight per cent. Fernandez felt that it was easier for Japan to make predictions because of the country's zero interest rate policy.

At the end of the day, policy makers can influence markets and should improve their communications strategy to inject more certainty into the markets. "Higher forward looking content value can help forecasters get the central bank's call right," concluded Fernandez.