Comments on
Dale, Orphanides, and Österholm,
“Imperfect Central Bank Communication: Information versus Distraction”
Lars E.O. Svensson
Sveriges Riksbank
SNB Research Conference, September 19-20, 2008

Paper’s main point
- If
  (1) Central bank (CB) forecast is worse than private-sector (PS) forecast and
  (2) PS incorrectly believes CB forecast is good,
then releasing CB forecast may be bad

My main points
- (1) and (2) unlikely combination
- If either (1) or (2) does not hold, releasing CB forecast is good

Simple signal-extraction problem
- PS forecast, precision $p$
  \[ x_t = \pi_{t+1} + \varepsilon_t, \quad E[\varepsilon_t] = 0, \quad \text{Var}[\varepsilon_t] = \sigma^2_{\varepsilon} = 1/p \]
- CB forecast, precision $q$ ($\varepsilon_t, \eta_t$ independent)
  \[ y_t = \pi_{t+1} + \eta_t, \quad E[\eta_t] = 0, \quad \text{Var}[\eta_t] = \sigma^2_{\eta} = 1/q \]
- Optimal (linear) combination of forecasts, precision $p + q$
  \[ z_t = \alpha^* y_t + (1 - \alpha^*) x_t, \quad \alpha^* = \frac{q}{p + q} \]
  \[ \text{Var}[z_t - \pi_{t+1}] = \frac{1}{p + q} < \min[\sigma^2_{\varepsilon}, \sigma^2_{\eta}] \]

Simple signal-extraction problem
- If PS knows $p$ and $q$, releasing CB forecast is never bad, no matter how poor
- For release to be bad, we need poor CB forecast and poor choice of $\alpha$
(1) is often wrong: CB forecast is likely to be at least as good as PS forecast
- CBs have and use more resources for analysis and forecasts than any single PS forecaster
- CBs know more about their own intentions than PS observers (instrument-rate path!)

Regarding (2), PS need not choose poor $\alpha$
- CBs indicate uncertainty in their forecasts (including instrument-rate paths), for instance by uncertainty intervals
- PS weight $\alpha$ on CB forecast has to be very high for the communication of poor CB forecast to be bad
- If precision $q$ of CB forecast < precision $p$ of PS forecast, optimal weight $\alpha^*$ on CB forecast < $\frac{1}{2}$. For precision of combined forecast $z_t$ to be lower than precision of PS forecast, weight $\alpha$ on CB forecast has to exceed $2\alpha^*$

Simple model-averaging normally good
- Let $\alpha = \frac{1}{2}$, equal weight on CB and PS forecasts
- For release of CB forecast to be bad, we must have $q < p/3$, precision of CB forecast must be less than 1/3 of precision of PS forecast
- Simple model-averaging normally good

Another point: Morris-Shin 2002 is pro-transparency, not con
- In Morris-Shin model, coordination motive makes PS put larger weight on CB forecast. Then releasing CB forecast may deteriorate welfare if CB forecast is poor
- Svensson 2006: Precision of CB forecast ($q$) has to be very bad, less than 1/8 of precision of PS forecast ($p$), for welfare to deteriorate

Conclusion
- Arguments against transparency not convincing: Unlikely combination of
  (1) CB forecast much worse than PS forecast, and
  (2) PS incorrectly believes CB forecast good
- Uphill battle to find good arguments against more transparency, especially against publishing instrument-rate paths
- Experience so far: More transparency has (almost?) always been better (Blinder et al., JEL forthcoming)