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Central Bank of Albania

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A PROPOSAL FOR THE INFLATION TARGETING COMMUNICATION STRATEGY OF THE BANK OF ALBANIA

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ABSTRACT

This Discussion Paper defines the Communication Strategy for Inflation Targeting of the Central Bank of Albania as the objective of increasing and reaching the (full) awareness of the public on monetary policy issues, in general, and Inflation Targeting, in particular. The Paper distinguishes between the period before and after the official launch of this monetary policy framework in discussing the tactics of this strategy. A gradual launch of IT is proposed and an intensive dialogue of the central bank with the different target groups in the society on promoting price stability as a necessary condition for a sustainable economic growth. The Paper further proposes the monitoring of the public's perception for steering its policy better. It unfolds furthermore the BoA's plans for the next two years.

1. INTRODUCTION

This paper lays down the communication strategy for Inflation Targeting (ITCS). It is a first attempt to write down the intentional steps to be made in the near to medium- to long-term future.

Our hope is that we will have a comprehensive discussion on this ITCS and that the final steps put on paper will be given a successful follow-up.

The outline of the paper is as follows. Section 2 sums the current communication tools and intensity of the communication of the Bank of Albania (BoA) on monetary policy, and IT, in particular. It explicitly mentions the obligations by Law. Section 3 puts Albania in an international perspective. The aim of this section is to point out specifics for our country that can help or hamper the communication. Section 4 discusses the steps for launching IT in Albania. The gradual character of the launch is stressed throughout. Next to this, the ITCS is defined as increasing and reaching the (full) awareness of the public on monetary issues in general and IT in particular. Section 5 thereafter describes the communication once IT has been launched. Section 6 provides in broad lines the main ingredients of BoA's actions for the calendar years 2007 and 2008. Appendix A contains empirical evidence on the Albanian knowledge on central banking and monetary policy, as an example to monitor the public's perception of the BoA's communication.

2. OVERVIEW OF THE CURRENT COMMUNICATION BY THE BOA

2.1. SOME WORDS ABOUT THE HISTORY

During the last years, the BoA changed from an institution that kept its decisions undisclosed into an institution that is convinced about the need for transparency pertaining its objectives and actions. The way of communication of the BoA with the external public has consequently drastically altered also.

The BoA made its first Economic Bulletin public in 1998. Since 1998 the number of publications has increased significantly. At the same time land-shifts occurred due to technological developments and our own experiences with the public.

For increasing transparency and communication with the external public, the world-wide-web page of the BoA became operative in 2002. This internet site has improved gradually and a new release will appear soon, making it more attractive to the public.

Box 1 A snapshot of the written and verbal communication

Written – published in hard copy and/or electronic form

- *Periodical reports*

Regular analyses appear in the Monthly Monetary Policy Report, Semi-Annual Monetary Policy Report, Quarterly Review of the Albanian Economy, Annual Report, Supervision Annual Report, Balance of Payments Bulletin, Monthly Statistical Report, Economic Bulletin, Survey Analyses.

- *Educational materials*

Publications aiming at informing the public on various issues related to the objectives and functioning of the central bank titled among others:

- (i) Speaking simply about inflation*
- (ii) The story about the ice cream*
- (iii) Central bank in brief*
- (iv) Banking system in Albania*
- (v) BoA's monetary policy instruments and procedures for their execution*
- (vi) The European Central Bank, Euro, our money!*
- (vii) The European community and the euro*
- (viii) What is price stability?*
- (ix) Preparations for the Euro*
- (x) Treasury bonds: How do we know them? What are their advantages?*
- (xi) Why do households need a personal budget?*

- *Others*

Presentations of the Governor in Parliament; News conferences; Legal set; Governor's lectures; BoA's history; News announcements; Discussion materials; Various manuals.

Verbal

- *Press conferences*
- *Speeches of the Governor or other administrators of the BoA at international conferences*
- *Informal meetings with the decision makers of the BoA and representatives from the Government, business, financial markets, media and academics*
- *Meetings of the Governor with the five branches and its regional representatives*
- *Interviews*

Electronic

- *Internet site www.bankofalbania.org*

Accessible to everybody, in an Albanian and an English version.

Only a part of the communication with the public has been an obligation by law. This concerns the bi-annual policy statement by the BoA to the Council of Ministers and the Parliament. All other communication, like the news conferences of the BoA, the meetings of the Governor in national and international forums with academics as well as representatives from businesses are the own initiative of the BoA. A precise regulation about the transparency and the confidentiality in the BoA appeared in 2000 by the Supervisory Council.

The historical overview of the Monetary Policy Report at the BoA for the period 1998 – 2005 can be found in detail in Shtylla and Suljoti (section III, 2006).

2.2. CURRENT PRODUCTS AND COMMUNICATION CHANNELS

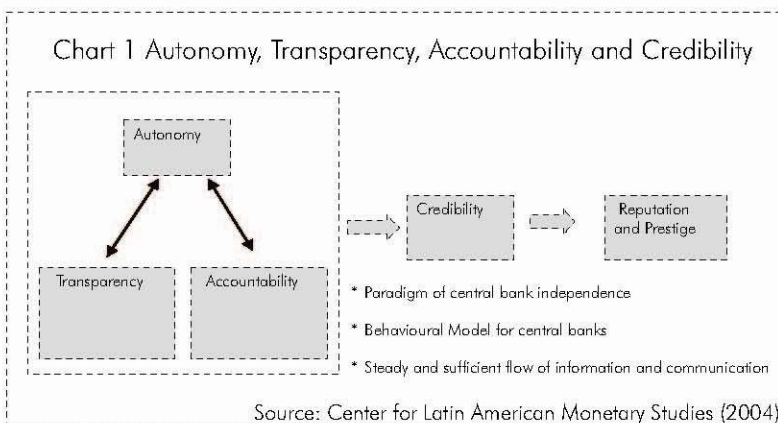
Box 1 lists the publications of the BoA split into the written and verbal ways of communicating, along with the channels chosen for communication with the public. The Printing House

of the BoA prepares all these publications, together with the Foreign Relations, European Integration and Communication Department (FREICD). The written publications are available in the library, by e-mail or ordinary post at request.¹

2.3. THE LAW, AUTONOMY, ACCOUNTABILITY, TRANSPARENCY AND CREDIBILITY

If a higher level of common understanding on the part of central banks diverse audiences is reached, central banks shall attain greater levels of credibility and transparency. This will contribute significantly to growing support for central bank institutionalism, in the sense of the autonomy² required to achieve their objectives. From this perspective the main responsibility of a central bank's communication policy consists in ensuring that its vision of the world is commonly understood, and in transmitting information in a language that is shared by the public.

This model shown in chart 1 highlights the interrelation between the three components of a process in the left box, indicated by the twin-headed arrows. If adequately implemented, the trilogy of components autonomy-transparency-accountability shall converge into the generation of credibility, which in turn will feed into the ultimate behavioural objective i.e. the possession of reputation and prestige. Credibility can be considered as a flow generated by the trilogy that contributes to a stock of reputation



and prestige. This behavioural model is enveloped and made feasible by a steady and sufficient flow of communication and information.

The interrelation between these three behavioural pillars of modern central banking indicated by the three boxes in Chart 1, although simple and at this stage obvious, contributes to emphasizing the dimension of the relationships between a central bank and its social actors.

An autonomous central bank operates under rules designed to prevent political interference. The BoA acts as an autonomous institution. It acts upon the decisions as taken by the Supervisory Council of the BoA. Following are some of the provisions as stated in the current central bank law pertaining to the autonomy of this institution.

From Law No. 8269 dated 23.12.1997 "On the Bank of Albania", article 1, point 3 it follows that "Within the limits of its authority established by this Law, the Bank of Albania shall be entirely independent from any other authority in the pursuit of its objectives and the performance of its tasks. Any person should respect the independence of the Bank of Albania, and no person shall seek improperly to influence any member of a decision making body of the Bank of Albania in the discharge of his duties towards the Bank of Albania or interfere in the activities of the Bank of Albania."

No later than six months after this law came into force and at six months' intervals thereafter, the Bank of Albania shall publish and deliver to the Council of Ministers and the Assembly of the Republic of Albania policy statements containing³:

- a) an assessment of the accomplishment and maintenance of price stability during the preceding 6 months and a prospective description for the next 6 months;
- b) an assessment of the monetary, credit and exchange rate policy implemented by the Bank of Albania during the preceding 6 months;

- c) a description of, and an explanation of the reasons for the monetary, credit and exchange rate policies to be followed by the Bank of Albania during the next six months;
- d) a description of the principles that the Bank of Albania proposes to follow in the adoption and execution of monetary, credit and exchange rate policy during the next two years, or a longer period upon the decision of the Bank of Albania.

2.4. CURRENT COMMUNICATION ON INFLATION TARGETING

Since last December, when the BoA stressed its intention to adopt IT as its monetary policy by organizing an Open Forum⁴, this regime has been mentioned to the public more often and more nuanced. During 2006 the BoA has referred to IT in several occasions for making the public acquainted. Table 1 quotes speeches and other oral communications by the Governor of this calendar year with a reference to IT. These communications counted about 30% of all communications by the Governor.

Table 1 Overview of Governor's speeches with a reference to IT in 2006

Date	Event	Speech of the Governor	Press release
20 January	XI Euromoney Forum	<p>"In the face of these forthcoming developments we are considering alternative regimes such as IT that could transmit central bank signals better and are more suitable for keeping the balance between economic shocks and inflation. There are theoretical benefits of the IT regime is comparison with other regimes as summarized in a series of paper by Mishkin <i>et al.</i> (1997, 2000 and 2002), such as the broader information base that it utilizes, its relatively higher flexibility with regard to supply shocks and the fact that it is easily understood by the public. On top of this, there is also the success of the other European transitioning and developing economies, such as the Czech Republic, Hungary, Iceland, Poland and Turkey. Bearing the above issues in mind the BoA retains that a switch to IT over the medium term will put us in a better position to strike the right balance between growth and stability. Accordingly, it has initiated steps to improve its governance structure and strengthen its analytical capacities, with technical assistance from the Fund. To this end, an Open Forum took place at the end of last year where top experts from all around the world discussed most of the issues regarding the implementation of IT. The main motivation for moving to the IT regime is the anchoring of inflation expectations in the medium to longer term while allowing some room to respond to shocks. I am conscious that going to fully fledged IT is a process that requires hard work with several preconditions in place. Our Forum clearly showed that it is not a one-off decision. It should be a smooth process. This holds in particular for a transitioning country like Albania. Our country faces different challenges and virtues compared with developed countries."</p>	

31 March	Meeting in Gjirokastra	“...We are trying to institutionalize this further, examining the possibility of adopting the inflation targeting regime, where the focus is precisely on the announcement and pursuance of a specified inflation rate...”	
22-26 April	At the Spring Meetings IMF and WB		<p>“The meeting concentrated on the macroeconomic developments and the macroeconomic situation in Albania, like the developments in the banking and financial sector, the objectives that the BoA has set regarding the implementation of the IT-regime...”</p> <p>“ ... The Governor mentioned the work of the BoA for the increase of its institutional capacity and its focus of the technical, institutional and legal preconditions needed for the implementation of the IT-regime...”</p>
25 May	Parliament	“...I would like to mention that after the Fifth Conference of BoA in March 2005, in Durrës, the peak of the public activity was reached in December, last year, when in the presence of the CEO of the BIS Mr. Knight, the BoA presented its monetary aspirations towards the framework of IT ... ”	

5 June	Conference Economic Governance in the EU	“...So, we are aiming to move to a more formal inflation targeting framework over the medium term. We have accordingly initiated steps to improve our governance structure and strengthen our analytical capacities...”	
26 June	Meeting with the Bosnian Herzegovian Governor		“ ...Mr. Fullani acknowledged his homologue with the BoA’s work starting in 2005 regarding the knowledge, analyses and implementation and required preconditions for the possible implementation of the IT-regime in the future... ”

3. ALBANIA IN INTERNATIONAL PERSPECTIVE

A “successful” communication by a central bank is at least timely, well-received and well-interpreted by the public. At the same time each central bank depends on many factors that it cannot influence itself. These, let us say, “exogenous” factors will have to be identified. In order to do so for the BoA we compare in this section Albania with other countries that recently introduced a new monetary policy strategy. After the identification we can point more clearly at those factors that may hamper our communication, on the one hand, and those factors that might facilitate it, on the other hand. But first we pay in this section attention to one aspect that is evidently within the influence of the central bank, its transparency, and we compare this with several other central banks.

3.1. TRANSPARENCY

Table 2 points out that the BoA is almost as transparent as the European Central Bank and the Federal Reserve Bank. This

follows from the overall index on transparency at the bottom of this Table indicating 8.5 points for Albania in 2006. Of the other countries shown, the Reserve Bank of New Zealand is most transparent with 14 points. The European Central Bank has only 10.5 and the Federal Reserve only 10. We can thus conclude that Albania is almost as transparent as these main institutions according to this measurement. From the marking of the components of the transparency index, shown in the rest of this Table, it follows that Albania underscores these institutions on e.g. the publication of its forecasts and the econometric models. This is where the BoA expects to catch up during the next year (as explained in section 5).

These outcomes are relevant to the ITCS as it highlights that the communication by the BoA receives a positive mark. In addition to the issues mentioned in Table 2 probably some other events, like the annual conference of the BoA, the speeches of the Governor (see Table 1) and the Open Forum or Round Table and the publication of their proceedings could be added. So in our view, if it comes to the timing and quantity of communication by the BoA, it is hard to point out shortages.

Let us now go to the exogenous factors.

Table 2 Transparency of the BoA in comparison with other central banks

Central Bank Transparency	BoA 2006	ECB	Bank of Japan	Reserve Bank of New Zealand	Swiss National Bank	Bank of England	Federal Reserve
Political Transparency	3	3	1.5	3	2.5	3	1
Formal Objective	1	1	0.5	1	0.5	1	0.5
Quantitative Targets	1	1	0	1	1	1	0
Institutional Arrangements/ Independence	1	1	1	1	1	1	0.5
Economic Transparency	1	2.5	1.5	3	1.5	3	2.5
Economic Data	1	1	1	1	1	1	1
Policy Models	0	1	0	1	0	1	1
Central Bank Forecasts	0	0.5	0.5	1	0.5	1	0.5

Procedural Transparency	1	1	2	3	1	3	2
Explicit Strategy	1	1	0	1	1	1	0
Minutes	0	0	1	1	0	1	1
Voting Records	0	0	1	1	0	1	1
Policy Transparency	1.5	2	1.5	3	2	1.5	3
Prompt Announcement	1	1	1	1	1	1	1
Policy Explanation	0.5	1	0.5	1	1	0.5	1
Policy Inclination	0	0	0	1	0	0	1
Operational Transparency	2	2	1.5	2	0.5	2.5	1.5
Operational Objectives	1	1	0.5	1	0.5	1	1
Transmission Disturbances	0.5	0.5	0.5	0.5	0	1	0
Evaluation Policy Outcome	0.5	0.5	0.5	0.5	0	0.5	0.5
Total	8.5	10.5	8	14	7.5	13	10

Source: Note (2005), and also Eijffinger and Geraats (2006)

3.2. OTHER RELEVANT ASPECTS

Table 3 lists aspects for Albania and some other countries that one could call “exogenous” factors to a central bank. It is obvious from these findings that Albania has an extremely low number of internet users, and a low media reach. On the other hand there are many bank offices in relation to the Albanian population. So, among others, this would favour a communication through the bank offices than through the media.

We will keep these facts in mind in addition to the fact that Albania is at a different stage of the transitioning process than many of the other countries.

Table 3. Comparison with other central banks in some respects relevant to the ITCS

	Albania	Romania	Czech Republic	Turkey	EMU
Average annual inflation in the last five years (before IT was launched)	3.11	29.08 %	8.5%		
Literacy rate	99%	97%	100%	87%	99%
Print media daily reach (WNA report 2005)	4%	49%	52%	65%	

Recent economic crisis	'01 / '97		1997	2001	
Population per bank (1,000)	184	570	293	1492	45
Population per bank office (1,000)	12	8	6	12	2
Internet users (per 1,000) in 2004	24	208	470	142	443
People without a bank account	82%				

Source: World Bank and Bank of Albania data for 2005

4. THE LAUNCHING OF IT IN ALBANIA

The BoA wants the launch itself to be a gradual process. In this Paper the formal start of IT is defined as the moment where the IT framework in all its aspects is announced in a special publication or event.

One may ask how big the changes will be in case of a move from the current monetary policy strategy to formal IT, from different angles like internal and external. Internally the BoA is moving to the development of all required internal analytical tools; the main deficiency is here the lack of timely and reliable data. From a viewpoint outside the BoA, the development of the CPI is stable, on an annual basis even most of the last 5 years around 3% +/- 1 percentage point at each quarter. In these respects the launch of IT would thus not imply a major landslide.

But ultimately most relevant, in order to make IT a successful monetary policy framework, inflation expectations of the main actors in the economy should be anchored to the 3%-target at the horizon of one year as defined in the IT-framework for Albania. It is here where we can identify two major points for attention:

- expectations by Albanian actors are in general short-sighted, i.e. not more than one quarter ahead,
- knowledge about the interaction of the development of prices (inflation), interest rates and economic growth and consequently also the interaction of monetary and fiscal policy is low.

We need to treat these issues but we will first define the Communication Strategy in general.

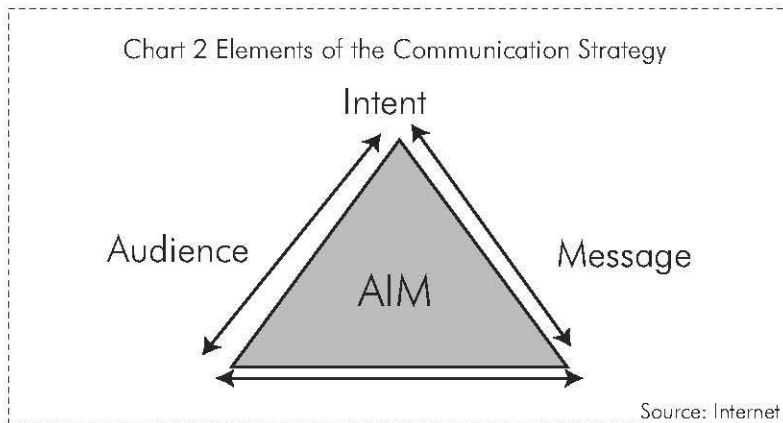
4.1. THE INFLATION TARGETING COMMUNICATION STRATEGY OF THE BOA

A strategy is a long-term plan of actions designed to achieve a particular goal of an individual or organization. Originally confined to military matters, the word became common practice in disparate fields, one of which is communication. A communication strategy is the plan containing details on the formal communications activities for achieving the goal.

People are not ideal information processors. Due to this fact, a central bank should give thought to the question of what its public needs to know mostly and how to express this in the best way. It thus needs to have a communication strategy and not simply a concern for transparency or convey of information and letting the receiver see whatever it wishes to see. This will hold for each central bank, but for Albania in particular due to its short central banking history. The BoA and its branches will have to build many more communication bridges.

It goes without saying that the BoA wants to achieve a successful implementation of the IT framework. The Communication Strategy of the central bank is in this context crucial. The goal of our Communication Strategy is to increase and reach the (full) public awareness on IT with the appropriate communication delivered to the different target groups at the right time for the sake of credibility.

It may take some time before this strategy comes fully to fruition. For now, in order to make IT a successful monetary strategy for Albania, the central bank envisages to make big steps towards the achievement of this objective.



In view of the before mentioned strategy the BoA should convey messages to the audience, which is the public of Albania, with the clear intent in order to elevate the public awareness on monetary issues. Chart 2 shows this triangle of audience, intent and message with the bilateral relations between each of the two elements. The main aim will be achievable by an appropriate interrelation of all three elements.

4.2. COMMUNICATION ABOUT WHAT?

The strategy is in essence about IT. More general is the need for understanding monetary issues that also include basic knowledge about the functioning of the central bank as monetary authority. We will come back to this general knowledge at the end of this section.

For communicating the IT-regime, there is a break down in the following components:

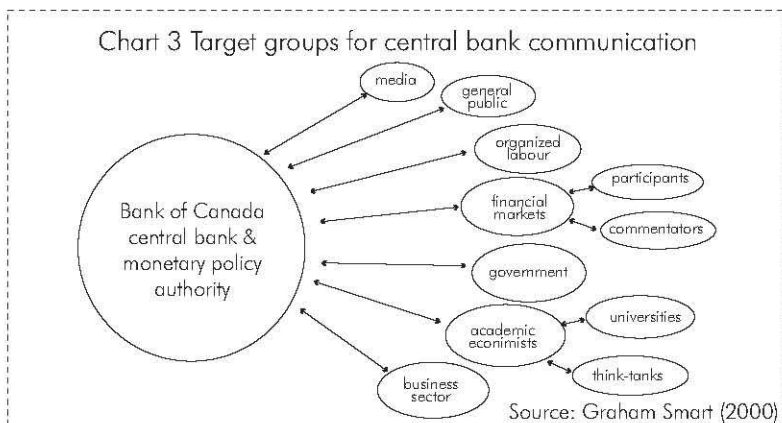
- a) The policy objectives – According to the Law on the BoA the principle objective is to achieve and maintain price stability. Under IT this will imply headline inflation 3% for one year ahead with a margin of +/- 1 percentage point.
- b) The policy framework – This is about the autonomy of

the central bank in relation to the government and the commercial banks, the transparency of the conduct of monetary policy and the accountability of the BoA to the public.

- c) The assessment of the inflation forecast and/or an evaluation of the economy – Only perceived by some groups of the public, as defined in the following subsection.

4.3. COMMUNICATION WITH WHOM?

The identification of the main target groups in Albania is a prerequisite for achieving an effective communication.⁵ Chart 3 gives a picture of the target groups of a central bank in its communication, by Smart (2000) for Canada, that could be applied for any developed country. Here below we distinguish five main groups in Albania and prioritise them on the basis of the current situation in Albania.



a. Parliament and Government representatives

In particular, a constant communication line between the BoA and the Ministry of Finance is a key for success of IT.⁶ At least, the BoA should have a formal acknowledgement by the Minister of Finance as it concerns IT. Seeking this support is high on the agenda of the Governor. See also Luçi, Gjermeni and Gazidede (2006).

b. Financial markets, the business sector, and trade unions' representatives

Meetings of the Governor with the directors of the commercial banks, representatives from the business sector such as the Chamber of Commerce and representatives of the trade unions will become even more relevant in the transition process towards a market economy. At the same time these business people are crucial in transmitting information on monetary policy to a broader public. They can explain monetary and financial issues orally and at the same time written material of the BoA can become available at their business locations.

c. Media and analysts

The media is a crucial group due to its influence on the public's opinion and understanding of monetary policy. The BoA intends to continue the organisation of specific meetings/trainings for all journalists and analysts on the IT, informing them on this regime and providing the background information for the motivation. The BoA will evaluate its performance after the trainings in the future. The outcomes of surveys may lead to a search for alternative ways for conveying its information effectively.

d. Academia and schools

The dissemination of IT can occur at a technical level. The teaching role of central bank experts can disseminate IT-information through a growing cascade.

e. General public

Rather than the IT regime, our focus will have to be first on the role and functioning of the central bank and the necessity of low inflation.

4.4. MONITORING OF THE ACHIEVEMENTS OF THE STRATEGY

The key decision makers in an economy are usually forward-looking, central banks affect the economy as much through their influence on expectations as through any direct, mechanical

effects of central bank trading in the market for overnight cash. As a consequence there is good reason for a central bank to commit itself to a systematic approach to policy that not only provides an explicit framework for decision making within the bank, but that is also used to explain the bank's decisions to the public.

The IT framework can be successful (if and) only if the actors in the economy anchor their inflation expectations according to the inflation target. For being able to do so, these actors will primarily need to have a good understanding of the functioning and role of the central bank in the economy.

In order to measure the progress that the central bank is making with its communication strategy of increasing the awareness of the public on monetary policy issues it is relevant to develop some monitoring tools. Appendix A gives an example for doing so. It analyses the outcomes of some recent surveys. The monitoring of the public awareness could in this way be done at a regular basis.

5. COMMUNICATION UNDER THE IT FRAMEWORK IN ALBANIA

This section concentrates on desired communication of monetary policy after the official launch of IT. It provides a list of tools aiming to communicate the monetary policy decision making framework to all stakeholders under the IT regime. The communication framework we intend to apply once inflation targeting has been launched is based on principles of transparency, on the structure of decision making body and on whether inflation targeting is flexible or strict.

The issue on transparent communication is based on the principle that the "central bank should reveal enough about its analysis, actions and internal deliberations for interested observers to see the logic behind each policy decision" (Blinder et al., 2001). For one reason, transparency partly serves to the accountability of the institution in exchange for the independence it enjoys. And second, it assists in aligning expectations with

policy objectives. In short, transparent communication is considered to be one of the most visible hallmarks of inflation targeting (Blinder and Wyplosz, 2004). For best results, central banks should communicate a great deal about the methods that are applied to guide policy decisions, including forecasts, and clarify ways of implementing policy changes.

Selection of communication tools under IT will also vary according to the way decisions on monetary policy are taken. Blinder (2004) argues that decisions on monetary policy are articulated differently if they are taken by consensus or by individual voting. In the first case, one voice for all will do, while in the second one, the diversity of opinions should be displayed to the markets. In BoA's case, it is presumed that the decision making body will take monetary policy decisions by consensus. Therefore, means of communication which will deliver these decisions are tailored accordingly.

The issue whether inflation targeting is strict or flexible relates more to accountability matters. How much should you explain to the public or how should you account for in case you miss the target. The BoA's inflation objective is a target point of 3.00 per cent with a tolerance of +/- 1.00 percentage point, which implies that it has enough flexibility in achieving the target. Further, BoA has been granted full independence since it has the right to formulate the monetary policy and set its own main objectives and tasks by law. From this perspective, it has the obligation to explain fully and with transparency its monetary policy decisions and implementation of these decisions, as well as deviations from the targets. It is held accountable to the legislation for achieving the target but this is limited to regular⁷ or on demand briefings and explanations to legislation rather than taking extreme punishment measures. For this reason, communication of policy matters will be based on explaining in an understandable manner the performance of monetary policy and reasons for deviations from the target.

Following is the list of items that will be used to communicate monetary policy under the IT. This list draws from experience of

other countries that have adopted IT as their monetary policy regime and that have been successful in keeping inflation under control. This list should not be considered exhaustive, and other items can be added or existing ones can be modified in the future according to the events that will follow.

a) Inflation Targeting Document

The release of this document will mark the official announcement of the IT regime by the BoA. The purpose of the document will be to describe the agreed framework in full detail. Autonomy, transparency, accountability and many related principles and features of the IT in Albania will be laid down. At the moment of the publication IT will be a logical consequence of all previous conscious steps by the BoA.

b) Inflation Report

All IT central banks produce Inflation Reports (IRs). It is an essential component of an inflation targeting bank's overall communication strategy. The purpose of the IR is to give background information for monetary policy decisions and hence it is a forward looking document. It also aims to provide knowledge about economic assessment from central bank and to guide externals to understand monetary policy. The frequency of IRs ranges from six to three months. As the target for inflation will be measured as an annual rate each quarter, IR Albania will measure inflation performance and policy adequacy on quarterly bases.

As described in Shtylla and Suljoti (2006), the IR will cover three main areas: (a) an analysis of the inflation developments with a view to comparing them with past expectations and to the target. Additionally, it will explore the factors that have determined headline inflation. This includes output, monetary developments and financial developments; (b) forecast of the inflation along with uncertainties associated with it. Along with the forecast, the report will present the baseline assumptions regarding external factors; (c) interpretation of the current situation and forecasts, together with future uncertainties, and monetary policy decisions suitable to the situation.

The IR is at the same time the main ingredient during policy decision making meetings. These meetings are planned to take place eight times per year. It implies that the cycle of the decision making process is around 12 weeks, ending with the IR and having another monetary policy meeting in between (as schematically outlined in the Manuscript)⁸. The work for building the IR will start by drafting an internal document that contains BoA's staff views on inflation outlook and different alternatives how the economic and financial situation might progress. This is what it is referred as situational report, which will be presented and discussed at the SC in a preliminary meeting. The IR will be produced outlining the most probable course of events and will be released for publication after the regular SC meeting. Being the most important document, which will explain future outlook and policy decisions at central bank, the report will aim to be written clearly, simply and transparently.

The IR will also satisfy central bank obligations of accountability to legislation. By law, central bank is held accountable to the parliament and explains policy actions regularly (as of now, the frequency is set biannually). The IR is considered to be the most thorough and complete document for doing that.

In line with the gradual approach for launching IT we propose to convert the current Monetary Policy Report over a two years period into an IR. The focus can go gradually more to inflation. As a major step, we propose the publication of the inflation forecasts in one year time. This should be done graphically for one year ahead with the use of a set of models. Whether or not this graphical presentation consists of confidence bands only, or a fan chart, is still a topic of our internal debates.

The quality of report writing can increase considerably in case the statistical framework becomes more mature. Statistics Department is currently building a user-friendly internal database that can over time grow into a fully-fledged data device for internals and externals. The quality of report writing can alongside also improve by putting more efforts and actual incremental news value in the reports from month to month,

or as we prefer it, from quarter to quarter. We propose to move to quarterly report writing as soon as possible. The main reason is that the news value of a new issue of the report will be significant.

c) Press release after the meeting

Decisions on monetary policy will be publicly announced as soon as they are made, with no informational advantage to a 'selected group'. In some cases, IR, when it contains monetary policy decisions, is a sufficient means to explain. However, press releases after the meeting will aim to strengthen the understanding of policies in the markets and help build confidence. Emphasis will be put on situations when inflation has moved outside the boundaries by providing careful and detailed explanations. This will also call for press conferences rather than simple press releases. Moving outside the boundaries does not pose a threat to central bank reputation as long as the latter is able to provide clear and reasonable arguments for that. Introducing press releases after policy meetings will add value to transparency, communication with the public and aid to increase policy efficiency.

d) Publication of the discussion paper on the inflation forecasting models

Preceding the official launch of IT the BoA intends to publish the document describing the current econometric forecasting framework drafted by experts of the Monetary Policy and Research Departments (Çeliku et al.2006). It is not only a decision making tool but also an important communication device. Publication of the specification of the econometric models will add to transparency of central bank policies and to the openness with the markets. In turn, this will promote stability in the markets and will help to predict the transmission of monetary policy in the economy.

Publishing a paper on the models is in our view recommendable before publishing the first inflation forecasts. It gives the public insights in the tools that are used for making these forecasts. The paper should be scientifically well-funded. At the same

time the forecasts as such can usually not straightforwardly be deducted from the models. Experts' judgment will be involved in any inflation forecast.

e) Publication of the discussion paper on the macro-econometric model for Albania

The recently developed macro-econometric model for Albania (MEAM) for simulation purposes is in the course of being used for internal simulation running for monetary policy decision making. A draft discussion paper is written by experts of the Research Department of the BoA (see Dushku et al., 2006). The paper treats the monetary policy transmission mechanisms in a broader sense than the inflation forecasting models. MEAM includes all transmission channels that are deemed important currently, either explicitly or implicitly. The BoA also intends to publish this model along with the inflation forecasting models (see the previous bullet). Possibly MEAM will also be used as a basis for making macro-economic forecasts. Prerequisite for this is that the statistical basis can be considerably improved.

f) Publication of minutes of the Board

The format of the minutes depends also on whether monetary policy decisions are taken by consensus or by individual voting. In the description of the committee on monetary policy issues, we assume a collegial decision. Accordingly, minutes will give a general account of opinions and expose main arguments in favour and against the decision taken without revealing individual votes of the members. Our objective is to be able to publish them with a delay of two weeks.

g) Appointing one member of the Board as a 'spokesperson' on monetary policy decisions – one view for all decisions

Conflicting signals can confuse market participants and other stakeholders. For this reason, it is recommended that the decisions will be more clearly conveyed if articulated by one voice. Since the monetary policy decision making body of BoA is a collegial one, the job to express one view becomes easier. All members are responsible for the decision, but one person can be appointed to communicate externally. Usually the role

is given to the chairman of the board, who in BoA's case is the Governor.

6. WAY FORWARD IN 2007-2008

On internal communication in 2007:

- a) Monitoring of the awareness of the public as mentioned in the first point under external communication here below, along the lines of the survey analyses in the Appendix by the FREICD and MPD. The outcomes have to be given a follow-up.
- b) Transparency and timeliness, broadness and deepness in the statistical framework and, in specifics, launch of a fully-fledged user-friendly statistical database by the Statistics Department.
- c) Regular presentations by the Research Department on the econometric inflation forecasting models and the MEAM in notes and internal seminars.
- d) Launch an intranet.
- e) Up-to-date information, preferably on an intranet, in particular on IT for stimulating and upgrading the awareness process of the own staff.

On external communication in 2007 - 2008:

- f) Communications by the BoA on inflation issues, among others informative programs with different target groups.
- g) Official publications on inflation issues.
- h) Surveys by the BoA will concentrate on inflation issues according to the ITCS, not necessarily in quantity but surely in deepness. The answers to elementary questions such as "What is inflation?" and "Which amount of inflation is the BoA's target?" are to be conveyed to the public.
- i) A gradual conversion of only the quarterly publication of the Monetary Policy Report into an Inflation Report, without publishing monthly reports.
- j) Graphical publication of inflation forecasts for one year

ahead in the Monetary Policy Report in the fourth quarter of 2007.

- k) Publication of a paper on the econometric inflation forecast models on the internet in English with a non-technical summary in Albanian – i.e. the updated and matured paper titled Inflation Forecasting at the Central Bank of Albania. This should preferably occur before the publication of the first inflation forecasts.
- l) Improvements in timeliness, broadness, deepness and user-friendliness in the statistical database on the internet.
- m) Publication of the paper on the macro-econometric model on the internet, in English with a non-technical summary in Albanian – i.e. the updated and matured paper titled A Macro-Econometric Model Approach for Albania.
- n) Launch of a fully-fledged internet.
- o) Make the Governor's speeches and Governor's performances gradually a concrete reference to IT.
- p) Start emphasizing the relevance of the independence of the central bank – via academic research papers by staff of the BoA and Governor's speeches.

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APPENDIX A. MONITORING THE PUBLIC AWARENESS

A.1. EMPIRICAL RESULTS

Some field information is available from 2003 for measuring the knowledge of the public about institutions and inflation. Employees of the central bank asked about 200 people in Tirana some questions in multiple choices in October of that year. Chart 4a presents the results of a question on the term “inflation”. It follows that the majority of 53% provided the correct answer that inflation stands for the increase of the price of goods and services in the economy. The other 47% linked inflation incorrectly with the exchange rate, the price of food or something else. The pies in Charts 4b and 4c show that the question about the institution that publishes inflation and the institution that is responsible for price stability got a correct answer by respectively 40% and 56%.

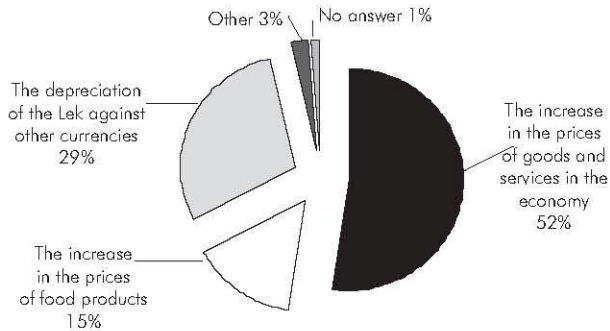
These outcomes on the knowledge of the public can be marked as positive, as a large share of these Albanian people gave the correct answers to these three questions. One may however wonder whether these outcomes are representative for the whole population in Albania. Probably there is an upward bias towards the correct answer due to sample selectivity. The survey took place only in Tirana, which is the capital where probably most people are familiar with the monetary economics life. Moreover, the choice of interviewees may have biased the answers as these central bank employees may have been questioning their relatives or close friends who know about the interviewee’s work.

Further analyses on this survey show that only 17% of the people in this sample gave the correct answer to all three questions illustrated in Charts 4a-4c. This correct-answering does not depend upon the gender, age or profession of the person taking part in the survey.

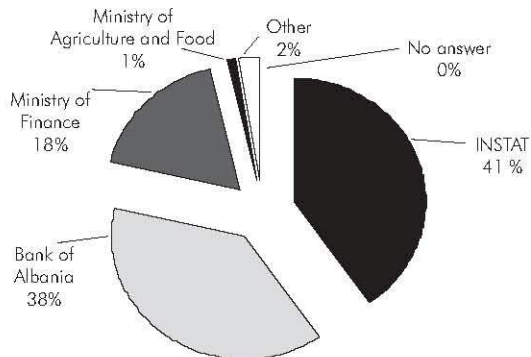
In July 2006 the public in Albania was asked specific questions on monetary policy issues. The national statistical office INSTAT took them as a part of the regular quarterly consumer confidence surveys among 1,206 households in Albania⁹.

Chart 4a-4c Knowledge tests on institutions and inflation in 2003

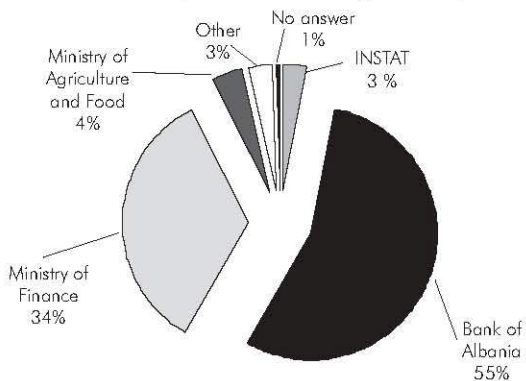
Graph 4a: What does "inflation" represent for you?



Graph 4b: Which institution measures and publishes inflation in Albania?



Graph 4c: Which institution is responsible for maintaining consumer price stability in Albania?



Source: Field questionnaire in Tirana among 199 persons in 2003 by employees of the BoA

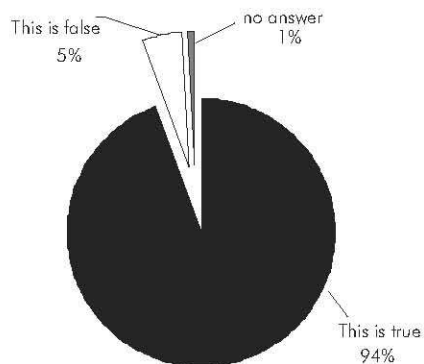
Charts 5a-5h illustrate the outcomes of eight questions that we indicate as “right” or “wrong” questions. The order in which they were asked is reported at the end of this Appendix. We graph them here according to the percentage of correct answers, from highest to lowest. We classify all black parts in the pies as “correct” and the other parts are “wrong”. So, the black slice gets smaller from Chart 5a to 5h.

Chart 5a shows that 94% households answer that economic growth is important for Albania. In a similar vein, Chart 5b indicates that 92% households deem price stability important for the country. More interesting to the BoA is the knowledge about the central bank. Chart 5c and 3d illustrate that 84% correctly answers that the central bank sets interest rates and 79% mentions even its correct name. We are moreover pleasantly pleased that, according to Chart 5e, even 74% of the households answer that stable prices are a prerequisite for economic growth. The concept of inflation seems though more difficult. Only 61%, see Chart 5f, knows its definition. Most difficult to answer seem the questions on the relation between interest rates and inflation and the task of the central bank. Only 42% knows that it is higher interest rates that bring inflation down (see Chart 5g). Chart 5h indicates that just a meagre 27% answer that the central bank is to keep prices low. Instead, the central bank is assumed to be responsible for economic growth first and foremost, by a large majority of 60% of the households.

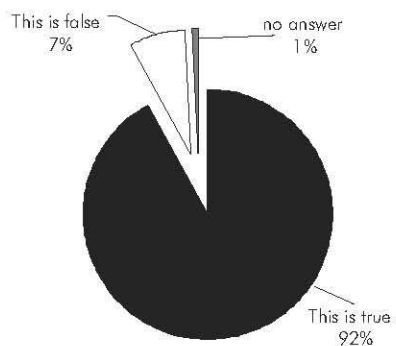
The results in Charts 5 and 4 are not conflicting. According to these results the public understands the concept of inflation, once a clear definition in a few multiple choices is provided. They also know the Bank of Albania. If it comes to the main task of the central bank answers seem to become fuzzier. The BoA could and should pay attention to its communication strategy to clarify its role. Also, surely according to these findings, the working of monetary policy is even harder to understand. But this latter point is for us easier to understand. A tightening monetary policy is probably also in Albania considered to be an unpleasant measure. In general people do not find it easy to grasp that a high inflation is only avoidable by means of such a tightening policy, so let alone in Albania where there is not yet a properly functioning monetary policy mechanism.

Chart 5a-5h Knowledge tests on monetary policy in 2006

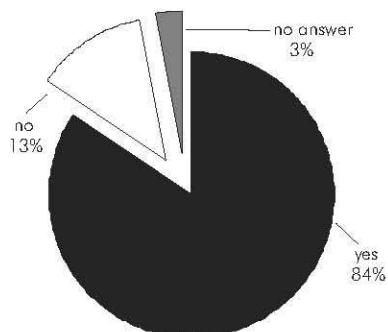
Graph 5a Economic growth is important for Albania



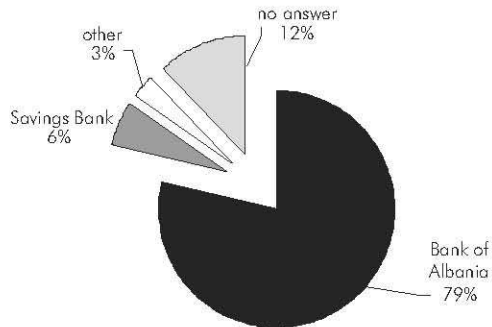
Graph 5b Price stability is important for Albania



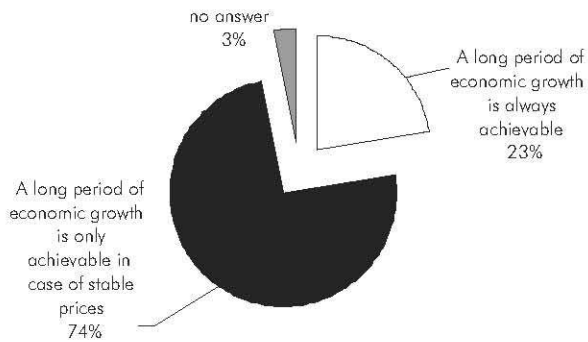
Graph 5c Does the central bank set interest rates?



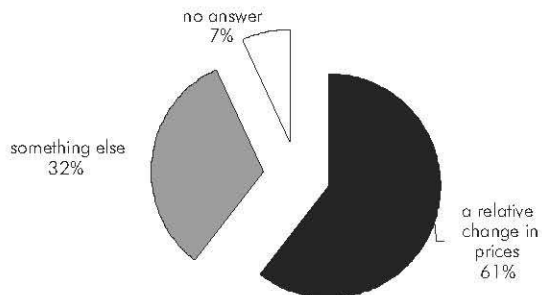
Graph 5d What is the name of the central bank?



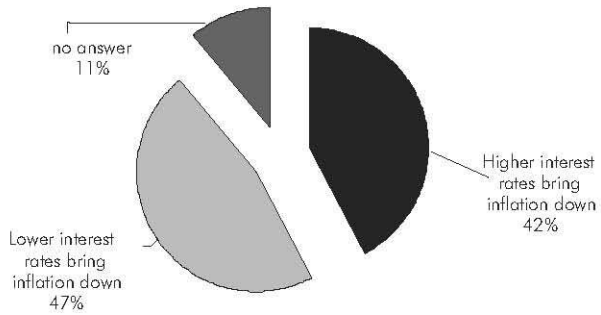
Graph 5e Which statement is true?



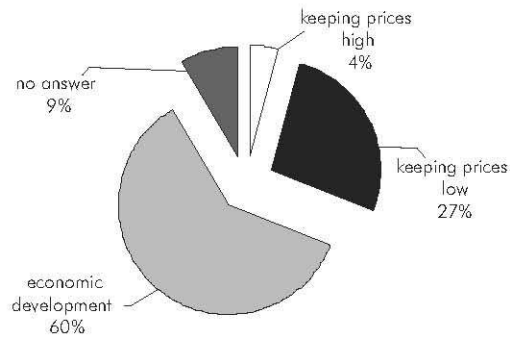
Graph 5f What is inflation?



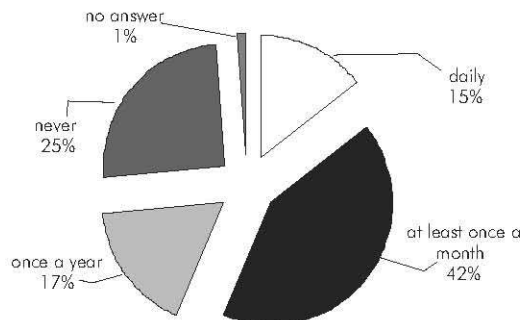
Graph 5g Which statement is true?



Graph 5h What is the main task of the central bank?



Graph 5i How often do you read in the newspapers or hear on TV about the central bank of Albania?



From this questionnaire we can draw some more inferences. We saw in Charts 5a-5h that many people give correct answers. A check on the number of households that gives only right answers turns however out disappointingly. Only 66 households, or 5.5% of the sample, answer correctly to all these eight questions. Interestingly, it turns out that 17 of these 66 households never read or hear about the BoA in the media and 6 only once a year. So, there is no strong link between the knowledge of the public about the BoA and its monetary policy on the one hand, and the presentation of the BoA in the media (see also Chart 5i) on the other hand.

Table 4 sheds some more light on the issue. In case this questionnaire of about 1,200 households is representative for the Albanian population, one concludes that 65% of the population “passes the exam” on the central bank and monetary policy; they know the name of the central bank, that the BoA sets interest rates and that price stability as well as economic growth is relevant to Albania. Many people (17%) loose track when the term “inflation” falls, let alone when the relationship between interest rates and inflation is mentioned (20%). The BoA’s future communication c/should focus on these topics in the near future for increasing this score.

Table 4 Knowledge of Albanian public on the BoA and monetary policy

	Survey questions	% of households providing cumulatively correct answers*
1	Economic growth is important for Albania	94
2	Price stability is important for Albania	90
3	Central bank sets interest rates	78
4	Name of the central bank	65
5	Long period of economic growth is only achievable in case of stable prices	52
6	Definition of inflation	35
7	Higher interest rates bring inflation down	15
8	Main task of the central bank	6

* The percentage in this row applies to a correct answer to the question in the corresponding and all previous lines.

It is further relevant for future communications to point out that each of these questions has a relatively high number of people

not answering or saying that they do not know the answer, i.e. the category "no answer" in the Charts. Concerning the name of the central bank, e.g., this category contains 12%. So, these 12% do not give an answer even after hearing or reading the multiple-choice answers among which the name Bank of Albania. It is remarkable that these people even do not want to guess. Also, even a question like in Chart 5i on the BoA in the media, has a non-response of 1%. Possibly people are ashamed to reveal their behaviour or true knowledge, or they are simply for another reason not pleased with all this questioning.

These "no answer" cannot come from a consistent non-response, as we eliminated this group from the sample. We mark this group as deserving more attention in the future. This is a group among the public for which the BoA has a task to fulfil. The BoA is to convince them on the relevant role of the central bank in all people's interest, and on the importance of having good statistics via questionnaires for policy purposes. The central bank can gain credibility, and should gain it.

More inferences come from econometric regressions. We run some probit regressions on the dummy variables right and wrong for each of the eight questions in the Charts 5a-5f. As explanatory variables we use the age of the respondent, his/her education, employment, and city.

The outcomes show us that the group of unemployed and the retired people score significantly negative on the questions concerning inflation, i.e. the definition and the relation to interest rates. The reason may be that their personal interest is more concerned with prices and that interest rates are not to their direct personal benefit due to the absence of savings or debts. This will hold in particular in their situation of a moderate social security or elderly benefit, or even penniless situation.

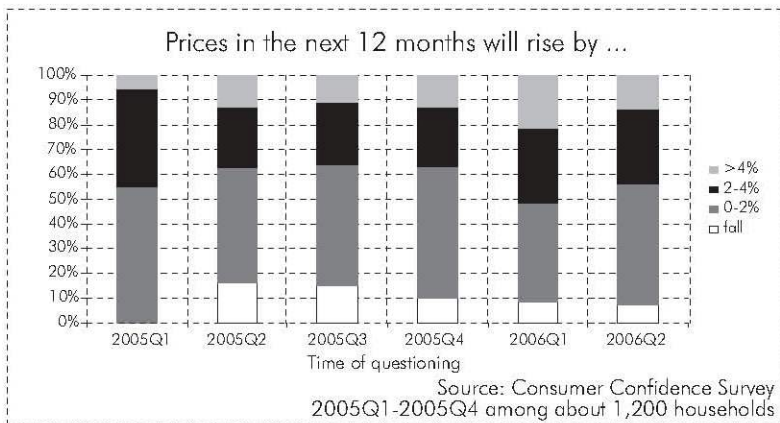
In contrast to these two groups, the self-employed provide significantly answers in line with our insights on the issues under investigations. Due to the fact that they have to run an own business, their awareness of financial matters may be more

extensive. Noteworthy is further that the group of employees in the government sector does not pop up significantly in our analyses. Like the employees in the private sector, there is no sign that they significantly affect the scores.

The respondents with a university degree significantly score better than the respondents with only a primary school education, if it comes to questions 3 until 6 in Table 2. Probably the basics of central banking and monetary policy were learned at the university and those who went there have not forgotten about it. For the other questions the education of the respondents does not seem to matter.

Also age does not seem to matter a lot. We distinguish in our questioning between the groups from 16 to 29 years, 30 to 49 years, 50 to 64 years and above 65. Only on the question of the definition of inflation, younger people significantly respond that this is about price changes whereas people above 65 significantly give another answer. But over all, for all these questions, age is not so relevant.

The smaller questionnaire among far less people, presented in Chart 4, included only people in Tirana. An advantage of this consumer questionnaire is that it stretches widely throughout Albania. The sample was held in 17 cities. Against our intuition, our econometric results show that the people in Tirana do not outperform the rest of the country. They definitely do not give



significantly correct (or wrong) answers. The city that clearly underscores is Lushnjë as most respondents get only 3 out of the 8 questions right. Also Lezhë and Sarandë turn out to be less informed on central bank and monetary policy issues.

Chart 6 provides information on the expectations of the 1,200 households on the future level of inflation with a one-year horizon. It follows that about 30% of the households in the sample foresaw in the second quarter of 2006 inflation in the range of 2% to 4% in the next twelve months, so in line with the inflation target zone that the central bank prophesizes. This 30% may not seem high. A comparison with the previous quarters shows though that the percentage has considerably increased. Remarkable is further that more people expect inflation to be lower than 2% than above 4%. This asymmetric perception is probably due to the relatively low inflation in the recent years or even, with a myopic view, considering the first months of this year (1.4% in January, 1.3% in February and 1.5% in March). It is also likely that “inflation” is confused with “consumer prices” that people preferably do not want to rise.

Regular and more information are required before drawing strong conclusions on these empirical results. The good news is though that these empirical results seem promising for IT.¹⁰

A.2. PRELIMINARY CONCLUSIONS

According to the analyses presented in the previous section we conclude that about 65% of the Albanian population succeeds in answering the basic questions on the importance of economic growth and the name of the central bank and its role as interest setter. A significant share of 17% looses however track when the term inflation is used. The stratifying of the sample according to education and place of living did not render any significant differences.

As a follow-up step to these results we suggest the following. First, simple ways have to be found to explain inflation to a broad public. In particular, the FREICD can find ways in their

oral communication to link this complicated term to “prices” that go much more to the pocket of people. Second, another type of stratification can be taken into consideration such as the target groups as distinguished in section 3. One may expect business people in the financial sector to be well-aware of monetary policy. Third, it can be kept in mind that the inflation forecasts will be published in a graphical form by the central bank. For the group of people that is familiar with the term their preference can be asked on e.g. 2 to 3 options for its presentation.

Some words on the questionnaire being prepared by the BoA-INSTAT-GTZ.

A.3. QUESTIONNAIRE IN JULY 2006 AMONG 1,206 HOUSEHOLDS

- 1) What is the name of the central bank of Albania?
 - a) Bank of Albania.
 - b) Savings Bank.
 - c) Other.
 - d) I do not know.

- 2) How often do you read/hear in the newspapers or on TV about the central bank of Albania?
 - a) Daily.
 - b) At least once a month
 - c) Once a year.
 - d) Never.

- 3) What is the main task of the central bank?
 - a) Keeping prices high.
 - b) Keeping prices low.
 - c) Economic development.
 - d) Something else.

- 4) What is inflation?
 - a) A relative change in prices.
 - b) Something else.

- 5) Having in mind Albania's economic conditions, what do you think is the optimal rate of inflation?
- a) 0%-2%.
 - b) 3%.
 - c) Above 3%.
 - d) Another percentage.
- 6) Does the central bank set interest rates?
- a) Yes.
 - b) No.
- 7) Economic growth is important for Albania.
- a) This is true.
 - b) This is false.
- 8) Price stability is important for Albania.
- a) This is true.
 - b) This is false.
- 9) Which statement is true?
- a) A long period of economic growth is always achievable.
 - b) A long period of economic growth is only achievable in case of stable prices.
- 10) Which statement is true?
- a) Higher interest rates bring inflation down.
 - b) Lower interest rates bring inflation down.

NOTES

* Ina Kraja, Director of the Foreign Relations European Integration and Communication Department, Erinda Nervaj and Rigers Kaso, specialists at the Foreign Relations European Integration and Communication Department, Doriana Lama, Head of the Financial Markets Office of the Monetary Policy Department and Marga Peeters, resident IMF monetary policy advisor. The authors wish to thank, without implicating them, Bledar Hoda, Niuton Mulleti and Sofika Note for their constructive comments on previous drafts.

¹ See www.bankofalbania.org or write to the FREICD.

² We prefer the term autonomy to independence as autonomy entails operational freedom while independence indicates a lack of institutional constraints (according to Lybek, 1999).

³ See Law No. 8269 dated 23.12.1997 "On the Bank of Albania", article 2, point 2, and the amendments in Law No. 8893 dated 25.07.2002.

⁴ The aim of the Open Forum was to reemphasize the BoA's intention to launch IT and to identify the preconditions for IT.

⁵ "The importance of a wide range of communication tools targeting various audiences can only be underlined for a successful monetary policy in a modern market economy" (see the comments of the ECB in the Proceedings of last year's Open Forum).

⁶ See the comments of Governor Jelašić of the Serbian central bank in the Manuscript of last year's Open Forum.

⁷ We deviate in our views from the views of Mr. Zdenek Tůma, Governor of the Czech National Bank as at the Open Forum of last year. Mr. Tůma of the Czech National Bank emphasized the regularity of the communication "All the more, *ad hoc* policy meetings based on *ad hoc* policy documents should be minimized. This not only helps the central bank in its communication with the public but also helps the decision making body to maintain internal discipline."

⁸ This scheme does not exclude situations where threats on inflation performance would call for immediate measures and an occasional meeting will be held accordingly.

⁹ For the purpose of our analyses 9 households were deleted from the sample for no-responses, to none of the regular questions, nor to these 10 monetary policy questions. So, 1197 households remain in our sample.

¹⁰ Other news follows from the study by Ilirjani and Parker-Stephen in the United States in June 2006. According to their findings 79.6% of 1,182 Albanian respondents trust the Bank of Albania. This is more than the presidency (79.3%), and far more than the local government (74.6%), the government (71.6%), the parliament (67.8%), the prosecutor's office (53.6%) and the court system (49.8%) in Albania.