

Internal rules for the preparation of, arguments for and presentation of monetary policy decisions

The Central Bank Act approved by parliament in May 2001 includes the following provisions in Art. 24, paragraph 3:¹

The Board of Governors lays down internal rules to be approved by the Supervisory Board on the preparation of, arguments for and presentation of its monetary policy decisions. Monetary policy decisions of the Board of Governors shall be publicly presented along with the rationale behind them.

The explanatory notes on this article, in the commentary accompanying the draft bill on the Central Bank, stated that:

Decisions reached at meetings of the Board of Governors shall be recorded in suitable fashion and confirmed with the signatures of the Governors. In order to ensure the most professional approach towards formulating and implementing monetary policy at all times, given the provisions on the Bank's main objectives in Article 3, it is felt that legal provisions are warranted for separate internal rules covering preparations of, arguments for and presentation of the Board of Governors' monetary policy decisions. For example, this refers to the procedures by which decisions are prepared, the information on which they are based and on the possible involvement of other Bank officials in this process, although ultimately the decision is formally made by the Governors. It is also important to give a clear

account of the Governors' decisions, especially those involving the use of the Bank's monetary instruments. Decisions are to be made public with an outline of the assumptions on which they are based and what they entail. The provisions in this Article seek to ensure the most professional possible basis for the Governors' decisions, transparency of monetary policy and the accountability of the Governors towards the government and general public. The Article does not oblige the Board of Directors to publish accounts of discussions at meetings when monetary policy decisions are made, nor of the standpoints of individual Governors.

At its meeting on January 10, 2002 the Supervisory Board of the Central Bank approved a proposal from the Board of Governors for internal rules on the preparation of, arguments for and presentation of monetary policy decisions, which are included below. The introduction describes the main principles on which the rules are based, concerning utilisation of information and expertise, professionalism, transparency and the documentation of arguments behind monetary policy decisions. According to the Central Bank Act, the Board of Governors has the authority to make decisions in monetary affairs. Among other things, the rules outline the Central Bank's main monetary policy objective. The inflation forecast plays a key role in monetary policy. In accordance with the joint declaration by the Government of Iceland and Central Bank of Iceland from March 27, 2001,² the rules stipulate that the

1. Act no. 36/2001. See "New Central Bank Act," *Monetary Bulletin* 2001/3.

2. This declaration was published in *Monetary Bulletin* 2001/2.

Bank shall produce an inflation forecast on a quarterly basis, projecting two years into the future. The rules specify that the forecast shall be produced by the Bank's Economics Department and that a detailed account shall be given of the assumptions on which it is based at any time. The Board of Governors continuously monitors economic and monetary developments and appraises the monetary policy on the basis of them with reference to the Bank's inflation target. *Monetary and financial meetings* perform an important function in this process. Once a month on average, a special assessment shall be made of whether the monetary policy is consistent with the Bank's inflation target. The Board of Governors confirms the inflation forecast and makes monetary policy decisions. The rules do not imply that the Board of Governors shall make monetary decisions on specific preannounced days.

The rules stipulate that monetary policy actions and the main premisses underlying them shall be made public as soon as possible. However, care shall be taken not to make them known while domestic markets are open for trading. In this context it should be pointed out that this procedure cannot apply in full to Central Bank interventions in the foreign exchange market. These are naturally made while markets are open and by their very nature are not announced in advance.

Finally, the rules state the importance of in-depth research by the Central Bank into factors concerning monetary policy and its implementation.

As mentioned above, the new Central Bank Act prescribes the setting of rules of this type. Even though their preparation has been under way for some time, broadly speaking the rules involve the formal documentation of procedures which have been followed at the Bank for some time. The rules will be reviewed as the occasion demands. Among other things, in the course of time it could be worth considering to decide in advance and officially announce the days when the Board of Governors shall assess and decide whether there is a need for monetary action to be taken, as is widely done.

The rules are as follows:

Internal rules for the preparation of, arguments for and presentation of monetary policy decisions

These internal rules are set with reference to the provisions of paragraph 3 of Art. 24 of Act no. 36/2001 on the Central Bank of Iceland. They are based on the following main principles:

- To ensure as far as possible that pertinent information and the expertise of Central Bank employees are utilised in monetary policy decisions.
- That monetary policy decisions shall be made using the best professional approaches, be well founded and be consistent with the Bank's objectives.
- That the decision-making process shall enhance the transparency of monetary policy and facilitate its presentation.
- That the assumptions and arguments behind individual decisions, and the way in which they were taken, are sufficiently documented.

Procedures

1. According to paragraph 1 of Art. 23 of Act no. 36/2001, the Board of Governors of the Central Bank has the authority to make decisions in monetary policy affairs.
2. According to Art. 3 of Act no. 36/2001, the main objective of the Central Bank of Iceland is to promote price stability. With the approval of the Prime Minister, the Central Bank has set a numerical target for inflation, which is on average as close as possible to a 2½% twelve-month rise in the consumer price index.
3. The Central Bank produces a quarterly inflation forecast which is published in *Monetary Bulletin*. The inflation forecast, which is made on the responsibility of the Board of Governors, shall be prepared in the Bank's Economics Department. It shall be produced using forecasting models available to and evolved by the Economics Department. The Board of Governors shall confirm the inflation forecast in writing. An in-depth account shall be given of the assumptions behind it.

4. The Board of Governors continuously monitors the economic and monetary developments and outlook, and appraises the monetary policy on this basis and in relation to the Bank's inflation target. The Board of Governors bases this appraisal on information from the Bank's various departments and their evaluations of the data they acquire and present to the *monetary and financial meetings*, cf. item 5. Furthermore, the Board of Governors relies on information acquired from interviews with representatives of various organisations, institutions and businesses.
5. The Board of Governors holds *monetary and financial meetings* twice a month on average, but never less frequently than once a month, with the Assistant Governor, Chief Economist and Directors of the International, Financial Stability, Monetary and Statistical Departments. The *monetary and financial meetings* shall include a presentation of the following information from individual departments of the Bank:

From the *International Department*: An evaluation of the position and outlook in international financial markets, and information about the Central Bank's foreign position and foreign reserve.

From the *Financial Stability Department*: An evaluation of the stability of the financial system and payments intermediation, including development and analysis of lending, defaults, credit institutions' equity and liquidity, and the financial and economic situation of households and businesses.

From the *Economics Department*: An evaluation of the various factors concerning the economic and monetary development and outlook, including global economic affairs and an evaluation of the monetary stance and macroeconomic factors in financial stability.

From the *Monetary Department*: An evaluation of the position, developments and outlook in domestic financial markets with respect to exchange rate developments, yields and turnover in them.

From the *Statistics Department*: Statistical data from the balance sheets of credit institutions and from the securities market, the balance of payments and its components.

Once a month on average, an assessment shall be made of whether monetary policy is consistent with the Bank's inflation target. More employees of the Bank may be called to such meetings than the regular attendees of *monetary and financial meetings*.

Information on the development of major macroeconomic indicators shall be maintained in the Central Bank's surveys Economic Indicators, which are supervised by the Economics Department. These indicators shall be published on the Bank's website.

The main assumptions behind the prospective inflation forecast shall be presented to the *monetary and financial meetings*. Subsequently, the Economics Department makes a forecast for submission to the Board of Governors.

The Chairman of the Board of Governors chairs the *monetary and financial meetings*. Participants there shall present and explain material originating from their departments. The minutes of the meeting shall state its main topics and the material presented to it.

6. The Board of Governors shall hold more frequent, informal monetary policy meetings as required.
7. The Board of Governors has the authority to make decisions in monetary affairs, cf. item 1, and is responsible for the Bank's official inflation forecasts, cf. item 3. Before an inflation forecast is confirmed or a final monetary decision is made, the Board of Governors holds a meeting with the Assistant Governor, Chief Economist and Directors of the Financial and Monetary Departments to examine the inflation forecast or the assumptions behind conceivable action, its scope and the arrangements for and content of official presentation of it. Other Bank employees attend these meetings as the Board of Governors

deems necessary at any time. Final decisions are made at a meeting of the Board of Governors.

8. Monetary decisions shall be officially announced with a press release from the Bank at the first instance. However, care shall be taken not to make them known while domestic markets are open for trading. Announcements of measures shall outline the main assumptions behind them and their relation to the Bank's inflation target.
9. The Board of Governors shall inform the Supervisory Board of the main elements of the Bank's monetary policy, cf. the provisions of Art. 28 of Act no. 36/2001.

10. The Board of Governors emphasises that in-depth research shall be conducted within the Bank into factors concerning monetary policy and its implementation, in order among other things to reinforce the Bank's appraisal of the outlook for price developments and to equip it better for evaluating monetary policy transmission and the transmission mechanism. The findings of such studies shall be published as the occasion demands.

These rules were confirmed at a meeting of the Supervisory Board of the Central Bank of Iceland, January 10, 2002.

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