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A shroud of secrecy

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A shroud of secrecy

A new survey by Steve Hanke and Matt Sekerke suggests that while central banks pay lip service to transparency, many of them do not practice it.

The veritable army of central bank watchers around the world attests to the fact that monetary authorities drape many of their actions with a shroud of secrecy and that the information hidden is significant and valuable. A growing number of experts advocate lifting the shroud, however. Indeed, at the institutional level, both the International Monetary Fund and the Bank for International Settlements have jumped on the transparency bandwagon. As advocates of less esoterica and more transparency, we have applauded these developments (Hanke 2001, Hanke and Morgenstern 2001).

If transparency is desirable, we must define it and determine which central banks pass over the hurdle. We define transparency by four simple tests. If a central bank posts current information in English about its balance sheets, off-balance sheet transactions and its enabling laws on a website, we deem it to be transparent. Admittedly, these are rather low standards. But, as we shall see, most central banks fail to clear even these low hurdles.

**Transparency:
the tests**

Before we present the results of our survey of the world's 174 central banks, a few words about our transparency tests are in order. A central bank's balance sheet is the foundation upon which any diagnosis of a monetary authority's activities must rest. A central bank's monetary liabilities, or high-powered base money, are contained in its balance sheet. The counterparts of base money – net domestic assets and net foreign reserves – are also displayed in its balance sheet. These important asset and liability categories allow an analyst to decompose base money into its domestic and foreign components.

It is the ability to decompose the monetary base that is often of vital importance. For example, a moderately growing monetary base might suggest that no trouble is on the horizon. However, that conclusion would be invalid if the modest growth in base money was motivated by a large reduction in net foreign reserves that had been offset by even larger increases in net domestic assets. Even when base money is growing moderately, a sure sign of trouble ahead – particularly when pegged exchange rates are employed – is when the foreign component of base money is shrinking rapidly and the domestic component is growing very

**Decompose the
monetary base**

rapidly. Indeed, this pattern has preceded virtually every currency crisis in recent years. This explains why most analysts, who only follow the course of base money growth and fail to decompose it, have such poor records in anticipating currency crises.

A balance sheet is also required to monitor whether a central bank is following the rule-based conditions laid down in many IMF agreements. For example, the IMF's most recent "Letter of Intent" with Turkey (June 19, 2002) specifies targets for the central bank's net domestic assets, net foreign reserves and base money. Accordingly, without a current balance sheet, observers cannot know whether the central bank in Turkey is meeting its commitments to the IMF.

Beyond the balance sheet A central bank should also disclose its off-balance sheet assets and liabilities. Off-balance sheet assets and liabilities include short-term foreign currency debt-service obligations and contingent claims on reserves related to financial derivatives. Disclosure of these obligations allows an analyst to assess the potential impact of these obligations. Needless to say, it is only by consolidating on- and off-balance sheet assets and liabilities that an analyst can obtain a full picture of the financial position and activities of a central bank.

To appreciate the importance of off-balance sheet items to a central bank, we must look no further than Thailand. In May 1997, currency traders took large short positions in the baht with Thai banks as counterparties. To absorb the concomitant risk to the banking sector, the Bank of Thailand (BOT) wrote offsetting forward contracts with the banking sector (selling dollars and buying baht forward), assuming a massive off-balance sheet long baht/short US dollar position. By May 15 1997 the BOT had, to a large extent, ended its interventions in the forward market but these on-going commitments were not disclosed. After the baht was devalued on July 2 1997, it became clear why the BOT's intervention had ceased. While defending the baht, the BOT had amassed commitments to swap US\$23.4 billion for baht in the forward market – commitments which substantially depleted the \$32.4 billion in foreign reserves recorded on the balance sheet at the time (Lall 1997, Leightner 1999). Without knowledge of the BOT's off-balance sheet commitments, many observers judged the BOT's level of foreign reserves to be adequate and were subsequently caught wrong-footed.

Publish the laws, too Central banks must also publish their enabling laws and the regulations pertaining to the banking sector. These documents are often required to understand and interpret the balance sheet. A central bank's enabling laws often provide definitions for categories on the balance sheet. These definitions are useful because they can dispel confusion about whether an account is an asset or a liability. For example, some central banks use the term "reserve money" to refer to currency in circulation (a liability), while others use the same term to mean (foreign) currency held in reserve (an asset). In addition, laws and regulations are needed to evaluate specific components contained within aggregate expressions presented on the balance sheet. For example, accounts on the central bank balance sheet which correspond to assets used in banking sector liquidity management (for example, "overdrafts and rediscounts") can be confusing if definitions are not available. Such assets may or may not be collateralised, and when

they are collateralised, the securities and financial instruments which are acceptable as collateral may be diverse and subject to frequent change. In this case, the information required to determine the quality of the central bank's assets will be contained in the banking sector regulations, if not in the central bank's enabling laws.

How many central banks meet minimal transparency standards? We checked for a balance sheet, off-balance sheet activities, and disclosures of enabling laws for the world's 174 central banks on the internet. Thirty central banks did not even clear the first hurdle: they did not have a website.

Of the 144 central banks with websites, 118 displayed some form of balance sheet¹. However, the balance sheets presented were not necessarily useful or relevant. When a balance sheet was present, we evaluated the balance sheet for its frequency and timeliness. Frequency refers to the time interval at which data are reported, and timeliness represents the lag between when a reporting period ends and when data are published². Data for the frequency and timeliness of balance sheet publication are presented in Tables 1 and 2. While most central banks publish monthly (or more frequent) data, very few do so with appropriate timeliness. A mere 48 central banks (28%) display data that are one month old or less³. When data are delayed for over a month, they are of little use for market participants and others who must make decisions quickly.

The balance sheets

Table 1. Frequency of balance sheet publication by central banks

<i>Weekly or more often</i>	17
Monthly or more often	85
Less often than monthly	16
<i>Total</i>	118

Table 2. Timeliness of balance sheet publication by central banks

Less than one month elapsed	20
Less than two months elapsed	28
Less than three months elapsed	23
Less than six months elapsed	25
Less than one year elapsed	4
More than one year elapsed	18
<i>Total</i>	118

¹ This, however, represents an improvement from last year, when 81 central banks posted some form of balance sheet, out of a sample of 123 central banks with websites. See Hanke (2001) and Hanke and Morgenstern (2001).

² For example, if a central bank publishes its accounts on March 31, 2002 for the end of 2001, with data for each month of 2001, the frequency would be monthly with three months' timeliness.

³ Our results on frequency of electronic balance sheet publication are consistent with studies on the print dissemination of central bank balance sheets. However, the timeliness of electronic balance sheet publication is far behind that of print publication. In a panel of data on 180 countries from 1996 to 2000 on the publication of central bank balance sheets, Allum and Agça (2001: 16, 22) found that most countries met monthly data frequency, and the average timeliness was two months.

Off balance sheet items The record for the publication of off-balance sheet assets and liabilities online is, predictably, worse than that for balance sheets. A number of central banks publish their off-balance sheet assets and liabilities using the IMF's data template on international reserves and foreign currency liquidity (IRFCL), introduced March 23 1999⁴. The IRFCL template, a part of the IMF's special data dissemination standard (SDDS) program, provides information (in US dollars) on foreign reserve assets, short-term (payable within one year) foreign currency obligations, contingent drains on reserves, and derivatives positions of the monetary authority and the central government. The SDDS guidelines require members to report these off-balance sheet activities on a monthly basis with one month's timeliness. By the end of 2001, there were 49 subscribers in compliance with SDDS rules, of which 43 publish the IRFCL template on the IMF website⁵.

Regrettably, growth in SDDS membership has been sluggish. By 1998, 47 countries had subscribed to the SDDS program, but no additional IMF members joined until 2001, when three new subscribers – Brazil, Tunisia and Costa Rica – joined⁶.

Looking for the law In addition to the financial disclosures mentioned above, we surveyed central bank internet sites to determine whether enabling laws were presented. Only 90 central banks publish the central bank law (their legal mandate) on their websites, and only 76 central banks publish any sort of laws and/or regulations pertaining to the banking sector. However, for those who only read English – the language of international markets and institutions – the list shrinks to 67 and 46 central banks, respectively.

Table 3. Summary of transparency test

Central banks with websites	144 (124 in English)
Balance sheet frequency: monthly or more often	102
Balance sheet timeliness: less than two months elapsed	48
Off balance sheet information published	43
Central banking law published	90 (67 in English)
Banking law and/or regulations published	76 (46 in English)
Central banking law and banking sector law and/or regulations both published in English	17
All criteria met (balance sheet available with appropriate frequency and timeliness, off-balance sheet information, and enabling laws, all published in English) ⁷	16

⁴ The IRFCL template was developed by the BIS's Euro-currency Standing Committee as a response to the Asian crisis and as a step to strengthen the SDDS program. An early version of the template is included in Bank for International Settlements, "Enhancing Transparency Regarding the Authorities' Foreign Currency Liquidity Position." 28 September 1998. <http://www.bis.org/publ/ecsc09.pdf>.

⁵ Iceland subscribes to the SDDS but is not in compliance until it develops a suitable producer price index.

⁶ The IMF (2001: 8) has also indicated that staff are working with Greece, Luxembourg, New Zealand, Russia and Uruguay toward subscription.

⁷ The countries which meet all four criteria are Bosnia and Herzegovina, Croatia, Czech Republic, Estonia, Hong Kong, Latvia, Lithuania, New Zealand, Philippines, Portugal, Singapore, Slovak Republic, Slovenia, South Africa, Thailand, and the United Kingdom.

The results of our transparency tests are summarised in Table 3. Obviously, **Very poor marks** the world's central banks earn very poor marks. These poor marks become far worse when one considers the low thresholds we have applied to our tests. When checking for a balance sheet, any kind of a balance sheet was accepted, whether it was clear or not. Most, in fact, were not clear, primarily because no standard format exists for central bank balance sheets. Consequently, it would take the likes of Sherlock Holmes to decipher the esoterica contained in most balance sheets. To correct this problem – and short of adopting a standard reporting format – central bank balance sheets should include detailed explanatory notes to the accounts (Perry 2000a, 2000b). The explanatory notes should explain the conventions used in valuing assets and liabilities, recognition of gains and losses, and aggregation of accounts. Additionally, the notes should include off-balance sheet transactions which cannot be precisely valued, potential operations that may impact liquidity and solvency, potential unrecognised losses, and an explanation of large changes in the accounts. □

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