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Research Article

Monetary policy transparency, inflation and the sacrifice ratio

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Abstract

We examine how inflation and the costs associated with disinflation episodes are related to monetary policy transparency. We develop a simple model that demonstrates how transparency may result in lower inflation. Our empirical results show that in general, transparency may be associated with lower inflation across a broad range of countries and frameworks. In addition, the output costs of disinflation, as measured by the sacrifice ratio, are negatively related to the degree of monetary policy transparency. The capacity of the central bank to limit the monetary financing of government deficits also has an inflation-reducing effect. Considering transparency as a possible determinant of cross-country differences in the costs of disinflation represents a new contribution to the literature, especially given the failure of previous empirical research to find a robust negative relationship between other aspects of the central bank's institutional design and the sacrifice ratio.
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