Principles 5 & 6: Independence, Transparency, and Accountability

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Hello everyone, I'm **Susanna Grigoryan**, an economist at the **Central Bank of Armenia** and a **Level One student at the Global Forecasting School**. In this video, we'll look at why independence, transparency, and accountability are the cornerstones of credible monetary policy.

Credible monetary policy depends not only on independence but on the discipline of an analytical framework that links forecasts, instruments, and objectives. A genuine forward-looking system has three essential ingredients. First, where is the economy today? It requires a coherent and internally consistent assessment of the current macroeconomic position—output gap, inflation pressures, and financial conditions. Second, what are the underlying forces driving it? That means a structured analysis of demand, supply, and external shocks, showing how transmission channels operate. And third, what must be done with policy instruments to achieve the objectives? It demands a systematic process that determines how interest rates and other instruments must adjust to keep inflation and output near target.

Any framework missing one of these three elements is incomplete. The Bank of England, as shown in **Bernanke (2024)**, never succeeded in developing this third component; hence, it never possessed a coherent forward-looking analytical framework.

Bernanke's independent review in 2024 found that the Bank's system relied heavily on judgment and an outdated model suite centered on COMPASS. Forecasts were conditioned on an exogenous or constant path for the policy rate—a practice that effectively pegged the nominal interest rate in the projections. This violated the most basic principle of modern policy analysis: the policy rate must be endogenous, adjusting in response to the forecast itself.

As **Milton Friedman (1968)** warned in his Presidential Address, pegging the nominal rate is inherently destabilizing. If inflation turns out higher than assumed, the real rate falls, stimulating demand and further raising inflation. In this way, an exogenous interest-rate path magnifies, rather than dampens, instability.

In a proper analytical framework, the forecast model determines the interest-rate path needed to achieve the inflation target, consistent with the central bank's reaction function. This link between objectives and instruments is what allows the policy process to be internally coherent and forward-looking. Its absence at the Bank of England—and similarly at other large, bureaucratic central banks—meant that forecasts could not reliably guide policy or communicate a credible story to the public.

By contrast, central banks such as the **Reserve Bank of New Zealand**, the **National Bank of Georgia**, and the **Central Bank of Armenia** built what we describe as Mark I Forecasting and Policy Analysis Systems, or FPAS. These frameworks explicitly integrate a structural model linking the economy's key relationships, a forecast process that endogenizes the policy instrument, scenario analysis for prudent risk management, and a communication system that explains policy choices transparently. In these institutions, the forecast and the policy decision are two sides of the same coin. The analytical framework ensures that every published scenario is consistent with the central bank's objectives and its best understanding of transmission mechanisms.

The **Prudent Risk Management Approach to Price Stability (2023)** defines the state-of-the-art analytical framework. It integrates the forecasting, policy, and communication functions into a unified decision system. Policy is derived from an explicit loss function that balances inflation and output stabilization under uncertainty, using scenario analysis to quantify risks. This approach eliminates the artificial separation between analysis and decision, ensuring that the central bank's instruments, objectives, and communications are fully aligned. Compared with this benchmark, the Bank of England's structure revealed by **Bernanke (2024)** was not merely out-of-date—it was conceptually incomplete. It failed to answer the third essential question: what must be done with our instruments to achieve our objectives?

Independence protects the central bank from political pressure, but independence without an analytical framework breeds confusion and weak accountability. Transparency and accountability arise when decisions can be traced through a disciplined process linking evidence, analysis, and action. The experiences of the **RBNZ**, **NBG**, and **CBA** show that smaller, more agile institutions can achieve world-class standards when they combine operational independence with analytical coherence and clear communication.

Independence gives us the power to act. Transparency and accountability give us the legitimacy to lead. Together, they form the foundation of institutional integrity and public trust.

Thank you for watching, and I would like to acknowledge **Douglas Laxton, Jared Laxton, Asya Kostanyan, and Sophio Mkervalidze** at the **Global Forecasting School** for their guidance and support in producing this video.

See you there.

Literature & Further Reading

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