Abstract

Does central bank stabilization policy change economic uncertainty about the driving forces of the economy? In this paper, I argue that the effect of monetary policy on the information content of aggregate variables depends critically on the extent of central bank transparency. To do this, I construct a simple analytical model and then demonstrate that the key results carry over to a dispersed imperfect information DSGE model. I show that monetary policy without central bank transparency induces a powerful two-sided learning externality, leading to a trade-off between households' and the central bank's knowledge about the driving forces of the economy. With central bank transparency, however, the choice of stabilization policy is to a large extent separated from its effect on economic uncertainty. Furthermore, I show that, when the monetary authority actively stabilizes endogenous aggregates, central bank transparency can decrease the level of economic uncertainty for everyone in the economy - even the central bank. This upends the "anti-transparency" result in Morris and Shin (2002, 2005).