Mr Duisenberg explains the thinking of the European Central Bank on the issue of whether markets need guidance

Introductory statement delivered by Dr Willem F Duisenberg, President of the European Central Bank, at the Frankfurt European Banking Congress Session I: “Do markets need guidance?” held in Frankfurt on 19 November 1999.

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Thank you very much for giving me the opportunity to explain the thinking of the European Central Bank (ECB) on this important issue.

Let me start by *summarising my answer to your question*: yes, the markets need guidance from the ECB. This guidance should mainly focus on reducing uncertainty in the markets. This requires above all a clear and credible commitment on the part of the ECB and sound economic analysis. Thus, guidance should be given through a credible monetary policy strategy and a transparent ongoing assessment of euro area developments in line with this strategy. Reducing uncertainty also implies that in our communication we do not pretend that we know more than we really do. Obviously, our knowledge of the future course of the euro area economy will always be subject to uncertainties and limitations. It thus goes without saying that guidance certainly cannot be given in such a way that the ECB indicates a path for future ECB interest rates far in advance.

This leads me directly to the *second part of your question*. (“Is any particular mode of guidance preferable?”) How should the ECB give guidance to the markets? At the heart of the answer to this question is the *Eurosystem’s monetary policy strategy*.

Indeed, this strategy is designed to make both our objective and the monetary policy aimed at achieving this objective credible, transparent and comprehensible, and thus make our decisions predictable. However, let me be very clear. Being predictable in no way implies that the central bank intends to follow the market. On the contrary, the causality should run in the other direction. Markets should be in a position to anticipate monetary policy decisions based on a credible strategy of the central bank. This does not exclude that certain monetary policy decisions may sometimes surprise the markets, but this is not our aim.

As was argued in an article in the most recent issue of the ECB Monthly Bulletin, a stability-oriented monetary policy contributes to reducing certain risk premia in interest rates and thereby to increasing the efficiency of the allocation of capital, thus enhancing overall welfare. This shows that it is very important to give clear guidance to the markets by conducting a credible monetary policy focused on price stability.

As you know, the strategy selected by the Governing Council of the ECB comprises a *quantitative definition of price stability*, which should contribute to anchoring long-term inflation expectations, as well as the two so-called pillars. The quantification of the primary objective, combined with the transparency and the credibility of the Eurosystem, provides the most important guidance to financial markets. Our monetary policy should contribute to keeping inflation expectations safely below 2%. This ensures a high degree of likelihood that future price developments will be consistent with the definition of price stability.

The Governing Council bases its monetary policy discussions on the information revealed by the two pillars of its strategy.

The *first pillar* is a prominent role for money, implying that monetary and credit developments are thoroughly analysed for their information content with regard to future price developments and risks to price stability. The prominent role for money is signalled by the announcement of a quantitative reference value for monetary growth in terms of M3. I like to emphasise again that the M3 reference value is not a monetary target. Monetary policy will not react mechanistically to deviations of M3 growth from the reference value.

The *second pillar* is a broadly based assessment of the outlook for price developments. This comprises analysis of many individual non-monetary indicators. We also look at macroeconomic forecasts prepared both externally and internally.

I know that some *analysts in the market would prefer if the Eurosystem had a very simple strategy*, where interest rates are changed quasi-automatically in response to a few (or even a single) observable variable(s). Some would prefer monetary targeting, others favour inflation targeting.

I acknowledge that our strategy is complex. However, we have to recognise that we live in a rather complex economic world and that there are additional uncertainties related to the changeover to the new regime of Monetary Union in the euro area. It would therefore be impossible for the Eurosystem to conduct a successful policy by mechanistically following a simple rule whereby policy decisions are closely linked to a few indicator variables or to a central inflation projection at a particular point in time.

Two key features of the ECB's communication with the public and the markets are our *Monthly Bulletins and the monthly press conferences*. The latter usually directly follow the first Governing Council meeting of each month. By these means we publicly conduct a detailed review of current monetary, financial and other economic developments in the euro area against the background of the strategy. This aims at illustrating the application of the strategy in practice, guiding market expectations. Although the strategy is complex, we generally try to end with an overall assessment which summarises the opinion of the Council on the future situation.

The *press conference provides prompt information in an even-handed way*, and it offers the opportunity for immediate two-way communication. As far as I am aware, no other central bank regularly communicates with the public in such a prompt and open manner immediately after its monetary policy meetings. We are convinced that this contributes to reducing uncertainty in the markets and thus gives important and clear guidance, also with regard to short-term policy moves.

In this respect, one should recognise that the ECB is facing a completely new environment. We do not only have to decide on the single monetary policy for a new monetary area comprising 11 independent countries, but also to communicate with the public and markets of these 11 countries, which were used to quite different monetary policy strategies and communication policies in the past.

This diversity of monetary history, communication and culture across the euro area obviously constitutes a great challenge for communicating in a comprehensible and transparent way both with the general public and the markets.

Obviously, journalists, financial markets and the public are still in the process of learning the new strategy of monetary policy in the euro area and, over time, the Eurosystem will further improve its communication.

Let me finally address *the third part of your question: ("does more information necessarily mean better guidance?")*. I am convinced that it is misleading to assume that more information always means better policy and a clearer guidance to the market. What is important is that the information given to the public is clearly structured and understandable, avoids adding uncertainty and is provided in an even-handed way. The Eurosystem's monetary policy strategy has been designed with these aims in mind.

Moreover, as indicated, a high degree of credibility of monetary policy can make a substantial contribution to reducing uncertainty in the markets and is thus a key aim of our policy. What is clearly more important than the amount of information given is that the communication policy, as part of the strategy, is consistent with the structure of the internal decision-making process. I can assure you that this is indeed the case.

During the monthly press conferences, I make an introductory statement summarising the Governing Council's discussions and conclusions before answering questions from journalists. As the statement is agreed, in substance, with all the Council members beforehand, it is similar to what others call minutes. I am convinced that, for the purposes of establishing credibility and reducing uncertainties in the market, informing the public of such an agreed position on the part of the Governing Council is superior to publishing details of a Council discussion which are naturally difficult to assess for those who are not present at the meeting. Moreover, as mentioned, we should not pretend to know more than we do. It is thus important not to try to give guidance when the ECB itself is not sure. I very much agree that giving too much information is not always helpful. I am convinced that the Eurosystem already provides timely, high-frequency information of good quality, but, as I have said, trying to further improve our communications is an ongoing exercise.