Otmar Issing: Monetary policy in a new environment

Speech by Professor Otmar Issing, Member of the Executive Board of the European Central Bank, at the Joint Bundesbank/BIS conference on “Recent developments in financial systems and the challenges for economic policy”, held in Frankfurt, 28-29 September 2000.

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1. The new monetary policy environment - challenges for the ECB

On 1 January 1999 the European Central Bank (ECB) assumed responsibility for monetary policy in the euro area - the second largest economic area in the world after the United States. Overnight, the euro became the currency of almost 300 million people. The transfer of responsibility for monetary policy from eleven national central banks - many of them characterised by long histories and impressive track records - to a new supranational institution was met with a great deal of scepticism. Sceptics noted the historically unique situation created by the asymmetry between, on the one hand, a single central bank and, on the other, eleven - and, with the participation of Greece from January 2001, soon to be twelve - national governments.

The adoption of the single currency marked a watershed in the history of European integration. It constituted a fitting climax to what was overall a period of impressive, if at times hesitant, progress in this direction through the second half of the 20th century. In the 21st century too, European integration will no doubt enjoy periods of progress punctuated by occasional setbacks. For example, while the enlargement of the European Union (EU) is an important goal, it will call into question the EU’s entire institutional structure. The single monetary policy will also be affected by the accession of new members.

This is simply one example of what will be the main theme of my remarks. Both the European Central Bank and the single monetary policy are - and will continue to be - faced with great challenges. Among these challenges numbers the continuing problem of high unemployment. Unemployment in the euro area remains intolerably high and constitutes the main economic and social problem facing policy makers. The euro area economy cannot exploit its potential for employment and real economic growth unless the implementation of appropriate structural reforms results in more flexible labour markets, less regulation in product markets and lower taxation. The best contribution monetary policy can make in this regard is to maintain price stability and low inflation expectations, thereby providing an environment in which structural reforms will work most effectively.

This having been said, an assessment made today of the first 21 months of European monetary policy confirms that the single monetary policy has been introduced with resounding success. During its short period of existence, the ECB can claim to have gained the confidence of investors in the sustained maintenance of price stability in the euro area. The financial markets act as objective and pitiless judges in this respect. The development of the long-term interest rate and other financial indicators confirm the credibility of the monetary policy of the ECB.

What makes these successes even more satisfying is that they have been achieved in what has often been a difficult and uncertain environment. The introduction of the euro took place in the aftermath of the Asian and Russian financial crises of 1997-98, which served to weaken external demand and increased uncertainty. Furthermore, the past years have seen a period of exceptional volatility in international oil prices, which has had implications for price developments.

The uncertainties related to these economic shocks are compounded by the significant regime shift associated with the transition to Stage Three of Monetary Union. The introduction of the euro has no doubt changed - and continues to change - the way expectations are formed in the euro area, thereby altering forward-looking economic behaviour. The effects of monetary policy on financial market, consumption, investment, and wage bargaining - and therefore the whole transmission mechanism of monetary policy to developments in the price level - have been among the important economic relationships more or less affected by this regime shift.

Of course, in itself this may be no bad thing. Indeed, the contribution of the regime shift implied by the transition to Stage Three to changing both public and private sector behaviour in favourable directions may be one of the largest gains that the euro area can extract from Monetary Union. Nevertheless, these changes have complicated the implementation of monetary policy, at least in the short term, as past relationships between macroeconomic variables may no longer be sufficiently reliable to constitute a basis for policy decisions.

The transmission mechanism of monetary policy to the price level in the euro area is therefore not known with certainty. This is hardly unique in itself - after all, no central bank operates in an environment of complete certainty. However, uncertainty about the transmission mechanism is exacerbated not only by the regime shift associated with the introduction of the euro, but also by the fact that, until quite recently, harmonised and comprehensive data have simply not been collected or constructed for the new monetary and economic area EMU created. Although a growing number of area-wide statistics are now available, they are based on new concepts, and the properties of the series are sometimes not yet well known. In some cases, the long runs of high quality back-data required for empirical economic analysis are unavailable.

These uncertainties - arising directly from the transition to Stage Three itself - are both compounded by, and inter-related with, the broader economic context in which Monetary Union was established. The increasing internationalisation of the global economy, and the current rapid pace of technological change, have affected all sectors of the economy, and the banking and financial systems in particular. One manifestation of these changes is the current intensive debate about the possible emergence of a so-called "New Economy" in the euro area. This debate is watched closely at the ECB and possible indications of a New Economy are carefully monitored. As yet, there appears to be relatively little evidence of a New Economy. Further structural reforms in the euro area may be required if the introduction of new information and communication technologies are to yield faster productivity growth.

All the factors I have just described will alter the relationships between economic variables that monetary policy makers have used as a guide to their decisions in the past. Nevertheless, I believe the ECB is well placed to meet the considerable challenges posed, inter alia, by these changes. It operates within a well-designed institutional framework that clearly delineates its responsibilities and objectives. It has articulated how these objectives will be achieved by announcing its monetary policy strategy. And it has at its disposal a modern and efficient set of monetary policy instruments.

Against this background, today I should like to focus in particular on two important and topical issues which are of direct relevance for monetary policy decisions: first, the role of the definition of price stability in the institutional framework of the ECB; and second, the role of forecasts in the ECB's monetary policy strategy.

2. The institutional framework

Monetary policy is not omnipotent. Unfortunately, this was not always recognised in the design of institutional frameworks for monetary policy. In the past, central banks have often been charged with meeting several, potentially conflicting, objectives. Because the central bank mandates underlying the definition of these objectives failed to respect the neutrality of monetary policy with respect to real variables over the medium term, many of these objectives were simply not realistic or achievable goals for monetary policy. Unsurprisingly, the resulting inadequately designed institutional frameworks led to poor overall economic outcomes.

Today, with the regrettable experience of high and rising inflation in the 1970s in mind, the capabilities and limitations of monetary policy are better - although still not universally - understood. A broad consensus now exists that the maintenance of price stability is the appropriate objective of monetary policy. This consensus is rooted in the belief that monetary policy makes its best contribution to overall economic welfare by maintaining price stability - and thereby allowing the relative price mechanism to work more efficiently. This proposition is strongly supported by a very broad economic literature investigating the medium-term relationship between real economic growth and price developments, both across countries and across time.

The institutional framework for the single monetary policy described in the Treaty establishing the European Community reflects this economic consensus. Of course, the Treaty was written with the experience of the 1970s - and the results of the academic literature that emerged in the aftermath of that unfortunate episode - in mind. First and foremost, the Treaty clarifies the objective of the ECB. The primary objective of the ECB is to maintain price stability. The Treaty therefore establishes a clear hierarchy of objectives for the single monetary policy, with price stability unambiguously assigned overriding importance.

The experience of the 1970s and 1980s not only demonstrated the importance of assigning central banks the clear objective of price stability. It also illustrated the advantages of central bank independence in the pursuit of this goal. A monetary policy subject to short-term political concerns and influences could not adopt the medium-term orientation required to maintain stable prices credibly. Academic studies of the time consistency problem in monetary policy, such as the seminal work of Barro and Gordon, offered an insight into this issue, while empirical evaluations showing a correlation between central bank independence and greater price stability provided compelling supporting evidence. By the early 1990s, the benefits of central bank independence had become conventional wisdom. An increasing number of central banks achieved greater institutional independence. This world-wide trend was reflected in the Maastricht Treaty, which made the ECB one of the most independent central banks in the world.

Assigning responsibility for an important public policy to an independent institution needs to be accompanied by a transparent and accountable policy framework. In a democratic society, a high degree of transparency and accountability in monetary policy making should bolster both the legitimacy of the central bank and public support for its price stability mandate. At the same time, transparency and accountability impose an external discipline on policy makers which can add to the credibility, and thereby the effectiveness, of monetary policy. The ECB has set high standards in both regards by establishing channels for communication and accountability suited to the specific, and distinctive, institutional and cultural setting in Europe.

I will return to the important issue of communication later in my remarks. With regard to accountability, let me simply highlight one crucial point. The institutional framework for monetary policy in the euro area assigns the clear objective of price stability to an independent European Central Bank.

Using a terminology developed in the academic literature, it is clear that the ECB enjoys “instrument independence” - that is to say, the Governing Council of the ECB is fully responsible for monetary policy decisions and the setting of monetary policy instruments. Yet the ECB is not “goal independent”. The primary objective of the ECB is mandated by the Treaty - it is not chosen by the Governing Council. The governments and parliaments of the Member States of the EU - representing the people who elected them - have chosen to enshrine the primary objective of price stability in the Treaty. On the basis of sound economic argumentation, this gives the primary objective a constitutional status. *Acting as sovereign bodies, the legislatures - but, of course, not the central bank - took a conscious decision to protect the mandate for monetary policy, namely price stability, from the influence of short-term political considerations, such as changes in government or upcoming elections.*

Of course, in principle nothing is set in stone for eternity. The objective for monetary policy could also be changed. A democratic procedure for such a change exists, namely an amendment of the Treaty. This is a constitutional process similar to that which originally set the mandate which requires approval by the legislatures of all Member States.

The status of the primary objective of price stability is therefore fundamentally different from that of an inflation target in a direct inflation targeting regime. Inflation targets are typically set by the government of the day for a fixed and relatively short horizon. In contrast, in the euro area the primary objective of price stability has a special constitutional - and thus lasting - status, placing it above shorter-term political influences.

Having been assigned the mandate to maintain price stability, the ECB - in view of its desire to be both transparent and accountable - could not simply have remained silent on how it interprets this concept. Consequently, drawing on the successful experience of those central banks which later formed the Eurosystem, in October 1998 the Governing Council of the ECB decided to publish a quantitative definition of price stability, both as a focus for inflation expectations and to provide a clear yardstick against which the public, its elected representatives and agents in the media, can hold the ECB accountable. The Governing Council therefore defined price stability as an annual increase of the Harmonised Index of Consumer Prices (HICP) for the euro area of below 2%.

Many considerations went into the formulation of this definition. In theory and prima vista, it would have been simpler to define price stability as a zero change in a specific price index. However, such an approach would have ignored important statistical issues, such as the potential existence and magnitude of so-called measurement bias in consumer price indices.

Nonetheless, one issue was clear. The ECB had no option other than to define its primary objective in a way that deemed inflation rates above 2% in the medium term inconsistent with price stability. This largely reflects the legacy of the definitions of price stability used by the national central banks (NCBs) prior to the irrevocable fixing of intra-euro area exchange rates at the start of January 1999. At the outset of Monetary Union with the introduction of a wholly new currency, it was extremely important that the public was reassured that the environment of price stability, which had been successfully achieved through the convergence process in the 1990s, was here to stay. Price stability should not be viewed as a temporary phase, but rather as a lasting - indeed, permanent - feature of the euro area economy.

Announcing a quantified definition of price stability and credibly committing to the maintenance of price stability on this definition helps to stabilise medium-term inflation expectations, thereby improving the effectiveness of a monetary policy aimed at price stability. The 1980s and 1990s provide ample evidence of the costs of inflation. These are often most visible during the process of disinflation, which is just the other unavoidable flip side of the preceding inflation. With price stability achieved in the euro area at the start of Monetary Union, it was vital that the associated benefits were "locked in" by the ECB.

It is especially important that those responsible for wage developments base their decisions on the clear commitment of the Governing Council of the ECB to maintaining price stability over the medium term. Short-run deviations from the primary objective which we observed in past months should clearly not be taken as a reason to end the process of wage moderation which has been so effective in contributing to the reduction of unemployment which we observed over the last years. It is crucial that medium- and long-term inflation expectations remain safely below 2%.

3. The monetary policy strategy of the ECB

The most difficult task for the European Central Bank was the development of a monetary policy strategy suitable for the new environment of Monetary Union. The definition of price stability which I just explained is one of the key elements of this strategy. Regarding the other elements, the Council recognised that options that had been tried and tested in a completely different context were, for a number of reasons, out of the question. While it was important to learn from the experiences and successes of other central banks, it was also crucial to recognise the new environment for monetary policy making in the euro area, and acknowledge the high level of uncertainty which was an inevitable result of the introduction of the new currency and the creation of such a large and complex currency area. A broad range of empirical and theoretical findings were taken into account in this unique situation.

While no central bank can afford to neglect the fact that ultimately inflation is always a monetary phenomenon, the conditions for a monetary target did not exist in the special circumstances prevailing in the euro area at the outset of Monetary Union. Two important questions therefore arose: first, how could the central bank specifically take into account the importance of money and, more generally, liquidity, for monetary policy making? Second, how should the ECB - in an honest and transparent way - account for the fact that, at least up to now, there is no agreement on the structure of the economy in general, and the precise role of money in the transmission mechanism of monetary policy in particular?

The Governing Council of the ECB has provided answers to both questions. As regards the first, the Council decided to assign a prominent role to money. This prominent role was signalled to the public by the announcement of a reference value for the growth of a broad monetary aggregate. The prominent role assigned to money implies, in particular, that the ECB is obliged to analyse the information content of monetary and credit aggregates with a view to identifying the nature of shocks hitting the euro area economy and assessing the resulting risks to price stability.

The prominent role of money constitutes the "first pillar" of the ECB's monetary policy strategy. The analyses underlying this pillar provide very valuable information which needs to be taken into account in forward-looking monetary policy decisions aimed at the maintenance of price stability over the medium term. Given the lags in monetary transmission, it is difficult at this still early stage of Monetary Union to make a thorough assessment of the importance of the prominent role of money. Nevertheless, with the benefit of hindsight, one can say that monetary analysis, and also the signals given by "headline" growth rates of key monetary aggregates, have proved more reliable guides for monetary policy decisions than many external observers anticipated when the strategy was announced two years ago. Of course, one can never exclude that monetary aggregates may be significantly distorted in the future. We may face shocks to money demand or special factors. Therefore, the Governing Council has always made clear that it does not react in a mechanistic way to monetary aggregates - rather a careful reading and thorough analysis of (headline) monetary developments will always be needed.

As regards the second question, the Governing Council recognised that although the monetary data contain information vital to informed monetary policy making, on their own they will not constitute a complete summary of all the information about the economy required to set an appropriate monetary policy which maintains price stability. Therefore, in parallel with the analysis of monetary growth in relation to the reference value, a broadly based assessment of the risks to price stability in the euro area - the so-called "second pillar" - plays a major role in the ECB's strategy. Analyses in which monetary and credit aggregates do not play a major role are consolidated in the second pillar. These analyses include the assessment of a wide range of non-monetary economic variables, such as labour market indicators, including wages and unit labour costs; fiscal policy indicators; and, financial market indicators, such as the yield curve and stock prices.

The two pillar structure of the ECB's strategy is often misunderstood by external observers as implying multiple targets for monetary policy, such as, on the one hand, an intermediate monetary target and, on the other hand, an inflation target. However, as I have already discussed, the maintenance of price stability in the euro area over the medium term is the primary objective of the strategy. *Both pillars of the strategy should be understood as instruments which help us to achieve this ultimate overriding objective. Taken together, the two pillars of the strategy form a framework which organises the presentation and analysis of the "full information set" which is relevant for monetary policy making in order to assess risks to price stability and allows for cross-checking of information from different sources and approaches.*

Precisely because of the lack of consensus about the structure of the economy and in particular the role of money in the transmission mechanism, economists are currently forced to work with a number of approximating models and frameworks, which each capture some important aspects of reality, but each of which is - when viewed on its own - inherently incomplete or mis-specified.

In this situation, a strict adherence to a single framework or model to the exclusion of alternatives would be unwise. It would carry the risk of making substantial policy mistakes if the framework used for policy turned out to neglect those aspects of economic behaviour which ultimately came to play an important role. In this context, a well-designed monetary policy will be "robust". It should ensure that price stability over the medium term is maintained in a variety of relevant possible settings or models of the economy, rather than narrowly focus on trying to pursue some narrow notion of optimality within one specific framework.

One implication of the need to make robust policy decisions is that there is a need to take an eclectic and diversified approach to guide policy judgements, incorporating as broad a range of data and analyses as is feasible. This approach will reduce the risks of making large policy errors. The two pillar structure of the strategy adopted by the ECB provides precisely this diversified approach and thus far has avoided making mistakes. This marks a not insignificant achievement in the environment of pervasive uncertainty which we face at the beginning of Monetary Union.

4. The role of macroeconomic forecasts within the strategy

The ECB is expected to publish macroeconomic forecasts for the first time at the end of the year.

Against this background let me clarify some important issues regarding the role of forecasts in monetary policy and in particular in the ECB's strategy. Many misunderstandings exist regarding this issue - not least on the part of some prominent observers and critics of the ECB.

There can be no doubt that forecasts play an important role in the monetary policy process. This is necessary given the forward-looking orientation of the ECB's strategy. Forecasts help to summarise and synthesise a large quantity of information that may otherwise become too unwieldy to form a sensible basis for policy discussions. Forecasts provide a platform for the integration of analysis in a coherent and internally consistent way, which respects accounting identities and basic economic relationships.

There are many organisations and public companies which regularly produce forecasts. The staff of the Eurosystem also does so. The Monetary Policy Committee (MPC) of the ECB, which brings together experts from both the ECB and the NCBs, is in charge of producing two forecasts per year. These are not the only forecasts which are produced within the Eurosystem, but they are certainly the forecasts which involve the greatest interaction between ECB and NCB staff experts.

The Eurosystem's macroeconomic forecasts are produced using a number of inputs. First, a variety of macroeconometric models of the euro area are used. Employing a suite of models, each embodying a different view of the world or estimated using a different methodology, is preferable to relying solely on a single - and inevitably imperfect - framework. Second, the projections produced by these models are influenced and adjusted using the technical judgement of staff experts both at the ECB and at the NCBs. Introducing such adjustments is standard forecasting practice and a necessary component of an effective forecasting procedure. Given this description of the Eurosystem's forecast process, it should be clear that forecasting is not treated as a mechanical exercise. Realistic forecasts cannot be produced by the mechanical application of a single model. Nor should they be.

The ECB forecast is thus produced twice per year by the staff of the Eurosystem and is based on the staff's technical expertise. *The forecast is therefore an **input** into the policy making process. The forecast does not embody the policy judgement of members of the Governing Council.*

When the public evaluates forecasts published by the ECB, the fact that forecasts are an input to policy making will be extremely important to keep in mind. The published forecast does not necessarily represent the opinion of members of the Governing Council. *Policy makers will always need to exercise a policy judgement in deciding how to interpret the staff forecast and the uncertainties around it. This exercise of judgement is part of what has been called the "art of central banking" - it is what distinguishes policy making from a purely mechanical or technical exercise.* Any blurring of the distinction between policy making - which is the preserve of the Governing Council and is ultimately captured in the final monetary policy decisions - and preparing technical analysis as input to the decision making process - which is the responsibility of central bank staff - will only serve to cause confusion.

Precisely because the exercise of policy judgement remains the preserve of the Governing Council, one should not expect policy decisions to feedback mechanically from developments in the published macroeconomic forecast. *Forecasts are only one - albeit important - input into the policy process.* They are always evaluated in the context of other analyses and indicators.

This is, by the way, true for all central banks. To my knowledge, there is no central bank in the world which bases its monetary policy decisions solely on a mechanical reaction to an inflation forecast. One reason for this is that macroeconomic forecasts suffer from a number of practical shortcomings which mean that they cannot constitute the only input into policy decisions.

For example, in practice the information from monetary aggregates is not incorporated into conventional macroeconometric forecasting models. However, monetary analysis is an important piece of information for assessing risks to price stability from a different perspective. As the ECB's macroeconomic forecasts rely on structural macroeconomic models, they should be seen as forming part of the second pillar of the ECB's strategy. These forecasts have to be cross-checked against the information from monetary aggregates for future price developments. This is the essence of the two pillar strategy. Both pillars, from different perspectives, analyse economic developments in a way which contributes to forming a judgement about risks to price stability and thus inform well-designed forward-looking monetary policy decisions.

When looking at forecasts, other aspects also need to be kept in mind. For example, the latest developments of key real economy variables cannot be fully integrated into macroeconomic forecasts in a timely manner. Moreover, the assumptions on which the forecast is based - such as the assumed paths of oil prices or external demand - can change rapidly, causing the forecast to become quickly outdated.

Furthermore, it has to be kept in mind that the projections which could be published by the ECB are the products of a technical exercise which are based on the assumption that policy interest rates will not change over the forecast horizon. For this reason, they are not true forecasts about future developments but merely an input into the decision making process which is designed to inform the Governing Council about what to expect *if interest rates are* ***not*** *changed for some time into the future.* Obviously, if the Governing Council identifies risks to price stability and acts on this basis by changing interest rates, the projections made by the forecast will not materialise. This is crucial to understand. The forecasts which will be published by the ECB are not predictors of the most likely outcome under all circumstances. Rather they will be scenario exercises describing what would happen if interest rates did not change. For this reason the Governing Council will make sure that, when forecasts are published, inflation expectations should and will remain firmly focused on price stability. The publication of conditional inflation projections should not in any way influence the formation of inflation expectations.

Of course, the Governing Council will continue to look also at forecasts produced by other organisations as well as financial market expectations, for example as embedded in bond yields. All this information should form the basis for decisions by the Governing Council and allows for the best possible insight into the situation.

All these remarks should make clear that the Eurosystem forecast does not constitute the sole or even necessarily the main vehicle for policy decisions. On the contrary, a key feature of the Eurosystem's strategy is that it permits a diversified approach to the assessment of economic developments and encourages cross-checking between different forms of analysis. This robust approach is intended to help avoid major policy errors.

My remarks should also have made *clear that neither the Eurosystem's strategy as a whole, nor the second pillar within it, should be characterised as inflation targeting.* More specifically, it certainly should be clear that monetary policy decisions do not feed back from deviations of the inflation forecast (based on the assumption of unchanged policy interest rates) from an inflation target at a specific time horizon.

Publication of macroeconomic forecasts would thus not change the ECB's monetary policy strategy. In particular, the role of forecasts in decision making which I have described at some length will be unaffected. The ECB has adopted a new and distinct strategy which reflects the complexity of implementing monetary policy in a large and diverse single currency area consisting of soon to be twelve different sovereign nations. This complexity is compounded by the challenges posed by the novelty of the monetary policy regime, which implies that the tools and approaches used to identify risks to price stability as well as the procedures used to produce macroeconomic forecasts for the euro area need to be continuously re-evaluated and monitored closely. Even less than would be possible under "normal" circumstances, in such an environment monetary policy cannot be reduced to reacting in a quasi-mechanical manner to monetary developments or inflation forecasts. The complexity of the environment requires a more sophisticated approach, embodied in the ECB's strategy.

Let me finally say that I am hopeful that the publication of macroeconomic forecasts will improve the presentation and explanation of monetary policy decisions to the public. By publishing an important input into the decision making process, the considerations facing the Governing Council when taking a decision should become clearer to the public. However, for this to be the case, both the assumptions underlying the forecast and the role of the forecast as an input into the policy process need always to be kept in mind.

5. The communication aspect of the strategy - transparency and accountability

The strategy must not only ensure that policy makers receive all the information required to take appropriate monetary policy decisions in a structured and coherent form. It must also constitute a clear framework for presenting monetary policy decisions, including the economic rationale on which they are based, to the public in a consistent manner over time. Today I should like to present just a brief discussion of this external aspect of the strategy, beyond what I already said regarding the role of forecasts. Regarding the latter l should simply like to stress again the crucial point that publication of forecasts would not change the strategy. The Council would not be responsible or accountable for the published forecast. Publication would be just one further step in our continuous effort to be a transparent institution by making available to the public information which is available to the Governing Council of the ECB. In this respect it is logical that we also intend to provide more information regarding the first pillar analysis to the public over time.

Much has been said and written about the communication of the ECB. It still remains true, however many times it is repeated, that the ECB, in terms of transparency, need not shy away from comparison with other leading central banks.

When discussing the presentation and explanation of monetary policy decisions by the ECB, it is important to recognise that the change in the environment for monetary policy making has been particularly challenging in the area of communication. The euro area consists of eleven - soon to be twelve - different sovereign nations, each with its own distinct monetary history and heritage. With each policy announcement or Monthly Bulletin, the ECB must thus communicate with the public of eleven different countries and must speak in all the official languages of the EU. Such a situation is unprecedented.

This diversity of language, history and culture across the euro area raises further challenges for the ECB. Over the years, each national central bank had developed its own strategy and, linked to this, its own "monetary policy language" for communicating with the public in the nation it served. This language reflected the unique circumstances of the country in question. Over time, the strategies and the related language and conventions of monetary policy came to be so well understood as to be almost second nature.

When the ECB announced its strategy in October 1998, some observers tended to look for those features with which they were most familiar and ignore or neglect others. These observers therefore formed an incomplete view of the strategy as a whole. Since their view and understanding of the strategy is incomplete, these observers inevitably find it harder than otherwise to understand the decisions taken within the context of the ECB's strategy.

Since the creation of the ECB there have been fruitful exchanges of views and discussions with many observers and watchers from different professions. To my mind, both sides have learnt a lot from these discussions and we are already beginning to see some clear improvements in the public's understanding of our strategy and decisions.

The ECB is sometimes criticised for pursuing a complicated two pillar strategy that is difficult to understand relative to the simplicity of “pure” monetary or inflation targeting. However, complexity is inevitable if the complex environment in which the single monetary policy is implemented is to be successfully confronted. The ECB’s strategy honestly and transparently reflects this complexity and does not attempt to simplify policy making in an unrealistic way. The Eurosystem has taken the view that by being honest, realistic and transparent about the intricacies involved in making monetary policy decisions, the credibility and effectiveness of the single monetary policy is enhanced and the primary objective of price stability is best served.

The ECB’s communication instruments are familiar. The press conferences directly following the first Governing Council meeting of each month and the detailed commentary on monetary policy in the ECB Monthly Bulletin stand at the centre. The Monthly Bulletin is intended to provide the general public and financial markets with a thorough assessment of the economic environment, as well as with articles about the economy’s structure and topical issues important for the single monetary policy. In speeches, members of the Governing Council also inform the public about monetary policy and the economy.

I believe that the explanations we give in the aforementioned contexts are perfectly comparable with what other central banks call minutes. In some respects - such as timeliness - the approach adopted by the ECB is clearly superior.

Moreover, working papers and technical analysis by ECB staff are published on their own responsibility for professional review and scientific assessment. Academic conferences have been organised by the ECB and the ECB staff participate actively in discussions with outside experts. All this information is widely disseminated via the ECB’s Website.

However, for good reasons, we have decided not to publish individual voting records, as this may create specific problems in the context of the new monetary policy environment. Obviously, the single monetary policy must adopt an area-wide perspective. If the voting records of individual Governors of NCBs were published, there is a danger that the public discussion of monetary policy is couched in national terms, thereby hindering the required development of an area-wide view. It may also expose Governors to national political pressures. For these reasons, individual voting records are not published.

The ECB recognises that its strategy requires a constant and active effort at communication with the public. Active communication is particularly important for the Eurosystem given its unique and new institutional position. The ECB wishes to be held accountable not just in a formal sense to the European Parliament as described in the Treaty, but also more broadly to the public at large. In order for the public to assess the performance of the ECB against the yardstick offered by the definition of price stability, the ECB must ensure that the public is provided with the relevant information.

6. Concluding remarks

I have described in some detail the main aspects of the ECB’s policy making framework. The monetary policy strategy in particular addresses the considerable challenges and uncertainties faced by the ECB and the Eurosystem in the new and unique environment created by Monetary Union. Our experience with the strategy has generally been good and I am confident that the robust approach to policy decisions embodied in the strategy has helped to avoid policy mistakes thus far. This is not an insignificant achievement.

Of course, we and others are still learning how to operate in the new environment. This learning process is particularly important in the area of communication. The ECB has always striven to be open and honest in its presentation of policy decisions and their rationale to the public. Provided that the role of forecasts in our strategy is properly understood - and the remarks I have made in this regard are of central importance - the publication of forecasts could help in our communication and presentation of decisions.