

Jean-Claude Trichet: Communication, transparency and the ECB's monetary policy

Keynote speech by Mr Jean-Claude Trichet, President of the European Central Bank, at the New Year's reception of the International Club of Frankfurt Economic Journalists, Frankfurt, 24 January 2005.

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Ladies and gentlemen,

It is a great pleasure to be here at the New Year's reception of the International Club of Frankfurt Economic Journalists. This is certainly the right place for me to discuss the "art of external communication". The members of this club are among the most experienced and knowledgeable watchers of the ECB. Through your reporting you play a decisive role in our communication policy. Along with other media you have the important responsibility of informing the public about the Eurosystem's monetary policy as well as other central banking activities and of contributing to a constructive public dialogue on our policies.

Much has been said about the external communication of central banks in recent years and central bankers have reflected intensively on their external communication. Transparency, candid explanations given to investors, savers, market participants, households and, last but not least, to our 306 million European fellow citizens are of the essence for the ECB and its Governing Council. It is fair to say that communication is an integral part of monetary policy.

Why are accountability and transparency so important for monetary policy?

Over the last few decades, it has been widely recognised that the maximum degree of independence for central banks, together with a clearly defined mandate, is the best way to ensure time consistency in the implementation of monetary policy and therefore to guarantee stable prices. Consequently, the Maastricht Treaty has granted the ECB full independence in the pursuit of its mandate. In a democracy, transparency and accountability are the quid pro quo for that independence. In other words, it is the duty of independent central banks to be transparent and to communicate. We help to make the ECB accountable by explaining our objectives and decisions to the general public, to the people of Europe, its elected representatives - namely the European Parliament - and to the professionals in the financial markets.

But transparency is not only a duty for a central bank. It is clearly also in the bank's own interest to embark on an effective communication as it contributes considerably to the efficiency of its policies. This helps to anchor the inflation expectations of the financial markets and the public. Through efficient communication we can reduce inflation uncertainty and the costs associated with such uncertainty for consumers and investors. Therefore it has immediate economic benefits for society. We achieve this by being clear about our strategy, clear about our definition of price stability and by being transparent in our actions. The economic agents and the public need to be convinced that the central bank's monetary policy decisions are consistently focused over time on achieving the announced aim.

In a market-based economy the central bank can directly influence only short-term interest rates through its monetary policy instruments. However, consumption and investment decisions, and thus medium-term price developments, are to a large extent influenced by longer-term interest rates, which depend on private expectations regarding future central bank decisions and future inflation. It is important that these developments in longer-term rates support the objective of maintaining price stability over the medium term. This in turn requires that the central bank is regarded as credible and predictable. A central bank which does not succeed in communicating the principles underlying its monetary policy and is perceived as acting in a non-systematic, discretionary manner will over time endanger its reputation.

Therefore, the central bank's communication should ensure that markets understand the systematic responses of monetary policy to economic developments and the current assessment of the central bank. Successful central bank communication supports predictability and correct price formation in financial markets, contributes to efficient allocation of funds and reduces uncertainty about future interest rates. In an environment where the predictability of interest rate movements and their relation

with key macroeconomic developments is well understood, firms can better manage their balance sheets. This reduces both their vulnerability to economic shocks and their risk management costs and creates the conditions for better investment decisions.

Finally, transparency contributes to macroeconomic stability and long-term growth by enhancing the price and wage setting mechanism, and by improving the functioning of the labour market. A credible monetary policy strategy oriented towards price stability contributes to moderate nominal and real wage developments. Workers do not have to ask for extra wage increases to compensate for inflation risk and firms know beforehand that they will not be able to pass higher wages on to consumer prices. Overall, transparent and credible monetary policy enhances firms ability to manage their production costs, retain profitability and create new jobs.

Transparency of the ECB

Let me now turn to the ECB and its concept of transparency and external communication. It was understood at an early stage that external communication would be crucial for the ECB. Already during the time of the European Monetary Institute the ECB's future communication policy was discussed; consequently, the ECB's Governing Council adopted some communication policy objectives and principles as early as 1998. They reflect the duty and "self-interest" elements already mentioned: since then we have communicated to enhance the effectiveness and efficiency of our monetary policy and to make the ECB, an independent central bank, accountable.

On this score, the publication of the key elements of the monetary policy strategy back in October 1998 constituted in itself a major step towards monetary policy transparency. One element of the strategy is to quantify what the ECB is aiming at in terms of price stability, namely an increase in consumer prices of below, but close to, 2% over the medium term. This provides guidance for inflation expectations. At the same time, it serves the purpose of accountability, for it sets a benchmark against which the ECB's performance in maintaining price stability can be measured. The ECB's monetary policy strategy also provides a clear and coherent framework for structuring analysis and our discussion in the Governing Council, and it has a remarkable role in structuring our external communication. From the start, it has helped to achieve the consistency between internal analysis and external communication which is the essence of transparency.

It is also important for the ECB and the Eurosystem to clearly communicate what monetary policy can, and cannot, achieve. For example, monetary policy cannot offset short-term changes in the inflation rate which are caused by economic shocks, such as sharp oil price increases or higher administered prices. It is thus a permanent challenge to explain any deviations in inflation from the definition of price stability. At the same time, it is essential for the public to be confident that such shocks do not call into question the determination and ability of the ECB to deliver price stability over the medium term.

Already the detailed public display of our monetary policy strategy as such is a very useful communication device. Of course, real situations are always more complex than the simplified representation that a single model or a single system of equations can offer. That is the reason why our monetary policy concept is as comprehensive as possible, relying both on an economic analysis and a monetary analysis, and it reserves a central role for judgement, for the collegial wisdom of the Governing Council. Explaining thoroughly and convincingly our assessment of complex situations is therefore of the essence.

It is this combination of full knowledge of the monetary policy concept and strategy, of precise arithmetic definition of price stability and of detailed explanations on the assessment of the ECB every month which permits market participants to have an intimate understanding of our policy and of the way it is implemented. In doing so a central bank avoids two opposed inappropriate behaviours. The first would be to give no guidance on its monetary policy and to communicate an unstructured, very complex and partially self-contradictory representation of the economic situation; such behaviour would not permit market participants and public opinion to be able to form pertinent expectations on future monetary policy decisions. On the other hand, a central bank cannot in normal times preannounce with an arithmetic precision its future monetary policy decisions. These must be derived from the full consistency between strategy and monetary policy concept, the medium-term price stability goal and the economic situation which is itself moving and always incorporates elements of uncertainty, chances and risks that can materialize. What is important is that at the moment of the decision, after having had the possibility of analysing all pertinent information and data, market participants can correctly predict our decision thanks to their intimate knowledge of our policy.

ECB's communication in practice

Some features of the ECB are bringing about major additional challenges for external communications. In particular, the ECB operates in a multicultural environment with 12 different cultures and 10 different languages in the euro area and 25 cultures and 20 languages within the scope of the European System of Central Banks. And, the ECB was given the very ambitious challenge to be fully credible from day one, without track record and to issue a currency which would be immediately as credible as the most credible legacy currencies.

In the practical implementation of the communication policy we make use of a wide range of communication tools. I will mention only a few of them here:

First, the monthly press conferences after the first Governing Council meeting in each month. The introductory statement at the press conference is a key element in our communication as it conveys the collective view of the ECB's Governing Council on the monetary policy stance in real time. In fact, the decision to hold a press conference after each policy meeting was unheard of among major central banks prior to the euro. To use real time detailed communication and press conferences in this way was a logical decision, bearing in mind (i) the attention the ECB would receive as a major player in the world financial markets and the global economy, (ii) the necessity to "frontload" the public and the markets with information on the thinking of the new institution and (iii) the interest as regards communication at national level through many different languages of having timely public terms of reference. I do not hesitate to say that this new ECB concept of real time detailed communication has been an important element of the new paradigm in central banking communication.

Second, there is the ECB's Monthly Bulletin, which is always published one week after the press conference. It gives a more detailed explanation of the analysis behind the monetary policy decisions. It regularly reports on information collected by the ECB, such as the bank lending survey. Importantly, it now also includes the ECB staff projections four times a year. An advance copy is published immediately after the Press Conference following the Council meeting. This is another example where the ECB has gone very far in making its policy transparent and communicating its economic assessment in real time. The Monthly Bulletin also contains articles which provide insights into the principles governing our policy.

Third, the members of the Governing Council members give interviews and speeches to many different audiences. In them they explain the decisions taken and the ECB's view on current topics within our sphere of competence. The decentralised nature of the Eurosystem is an asset especially for communications with the general public. The Governors address in their country their national public in their own language. They are very well placed to participate in economic debates taking place in their home country.

Finally, the ECB publishes a large array of statistics, adding essential information on the euro area available to financial markets and all other interested agents. There has been an ongoing process of extending the number of statistical series released by the ECB, which I expect to continue in the future. As a latest example, last week we have published for the first time a press release providing a geographical breakdown of balance of payments and international investment position statistics.

Our concept of transparency

Transparency serves our main objective of maintaining price stability. As we are a unique institution which has no precedent we have to consider very carefully the appropriate concept of transparency in our decision-making.

We are convinced that as a collective body it is beneficial for the Governing Council to give its collegial assessment in the form of a comprehensive and detailed statement rather than only stating the decision and letting the interested parties wait for the detailed statement to be published later in the form of minutes.

Our method of real-time communication on behalf of the Governing Council also goes to demonstrate that we are collectively accountable to the public. Each of us inside the 18-member Governing Council has to take into account the superior interests of the whole euro area. My colleagues and I are convinced that our present real time detailed communication is, in our case which is unique, superior to mentioning individual votes which could wrongly suggest in the eyes of some that the Governing Council is a place where we are confronting national interests which is not the case and should never be the case.

As the “porte parole” of the ECB and its Governing Council, I think it is remarkable that we act as a team with high team spirit as regards the handling of a complex communication network dealing with 306 million European fellow citizens speaking their languages. The “single voice” principle in monetary policy was introduced from the very beginning and has been efficiently applied in my judgement.

As regards non-monetary policy decisions by the Governing Council we have adopted a new procedure in December by placing a communication on our website one day after the second meeting of the month. Previously we communicated these decisions in various ways, for example by press releases or by inserting information under other matters into the introductory statement. I hope that the new procedure will contribute to easier access to non-monetary policy decisions. The document refers to “Decisions” which means that, as a rule, it will cover those issues for which the Governing Council has concluded its deliberations, i.e. decisions have been taken.

Has the ECB been successful in its monetary policy communication?

Having talked about the objectives of transparency and modes of external communication, I’d now like to consider how successful the ECB has been in establishing credibility and predictability.

Evidence can be gained from financial markets and economic surveys. A key indicator of the credibility of ECB monetary policy comes from expectations of inflation implied by the differences between the returns on index-linked and nominal bonds and inflation-linked swap rates. When looking at these market prices, one has to bear in mind that the spread between these nominal and real yields not only measures market participants’ inflation expectations, but also carries the inflation uncertainty risk premium which investors require as compensation for the risk of a loss in purchasing power. Keeping this in mind, and also looking at various measures of long-term inflation expectations in the euro area, such as Consensus Forecast and the ECB’s Survey of Professional Forecasters, one can say that long-term inflation expectations have been pretty well anchored by the ECB’s quantitative definition of price stability from the beginning of the Euro. This is a remarkable success that observers and markets considered quasi impossible before the euro was set up. This does not mean that there is any room for complacency. Continued vigilance is key to preserve credibility and some increases in long-term inflation expectations last year remind us how important it is to be permanently vigilant.

As regards the short-term predictability of monetary policy, policy moves have been pretty well anticipated by money markets. Recent studies by academics have confirmed the predictability of the ECB at the highest level amongst major central banks. Investors have indeed become more confident in their forecasts of future short-term interest rate developments prior to ECB monetary policy announcements. Bond market indicators paint essentially the same picture. Implied bond market volatility in the euro area is currently close to its lowest level since January 1999.

Communication is an ongoing challenge

Financial markets evidence indeed indicates that we as a central bank have managed to be understood by market professionals. But this is only part of the picture and should give no reason for complacency. We are well aware that earning people’s trust in the credibility of the ECB remains an ongoing challenge. And we know that the familiarity of the general public with the Eurosystem and the ECB still needs to be further enhanced.

One indication of the daunting size of our communication task was the issue of so-called perceived inflation rising much higher than the actual measured inflation. It has turned out to be difficult to explain people that they should not judge the general price level just by observing the prices of some individual goods. We see the dichotomy of different target groups in the fact that there was at times a heated debate about deflation risks among financial analysts while at the same time the general public was deeply concerned about inflation. Fortunately, the gap between perceived and actual price developments is narrowing down again significantly.

We are responsible for ensuring price stability for 306 million people in the euro area, who use the euro and make economic decisions every day. So it is essential, absolutely essential, that we preserve and enhance their trust in our single currency. They know they can rely on us to preserve their purchasing power over time. We are an anchor of stability created by the Treaty to ensure low inflation, in line with our definition of price stability.

Let me conclude on a more personal note.

The times when central banks were rather reclusive and closed institutions administering interest rates with some dedication to surprise observers and markets have gone. One of the main goal of a responsible central bank now is to have a reliable communication guiding expectations in a rapidly changing environment. In this respect one has to fully realize that the ECB has unique challenges to cope with.

First, when we start the press conference the Vice-President and I know that we are speaking in quasi real time, through all of you, not only to European market participants, investors, savers, economic agents, entrepreneurs but also to all our European fellow citizens to whom we are accountable as a last resort. This is already a demanding and exciting task taking into account the fact that we are the only major central bank embarking on a press conference immediately after the monetary policy meeting.

Second, on top of that, we are fully conscious that we are speaking simultaneously to twelve different cultures today, and many more when time comes. Making sure that a decision is exactly understood simultaneously by a German, an Italian or a Spanish household, by an Irish, a Portuguese and a Dutch citizen is another extraordinary challenge that no other central bank has to cope with.

Third, last but not least, we are also simultaneously speaking to the global market participants who have themselves their own language and their own culture.

For the ECB to be credible means being credible vis-à-vis all parties concerned. Our transparent communication must permit all parties to understand our mandate and our strategy to ensure price stability, to anchor their medium term and long term expectations and to accurately predict our future behaviour.

For the European and global market participants in particular I know how predictability is important. I attach the utmost importance to our predictability which has been very good in the past, thanks to our conceptual transparency, to our own candid explanations on our diagnosis and decisions and - last but not least - to the quality and lucidity of yourself, members of the Frankfurt Economic Journalists, of ECB watchers in general, of economists and of market participants. I will continue to take care that this predictability remains as excellent as possible.