

## **Jean-Claude Trichet: A few remarks on communication by central banks**

Keynote address by Mr Jean-Claude Trichet, President of the European Central Bank, at the 25th HORIZONT Award Ceremony, Frankfurt am Main, 16 January 2008.

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Ladies and gentlemen,

It is with great pleasure that I have accepted the invitation from HORIZONT on the occasion of the 25th anniversary award ceremony. I am honoured to see so many distinguished guests from the German media and communications industry in the audience. The long-standing tradition that this event enjoys demonstrates that media and communications play an important role in all aspects of modern societies, including, though perhaps more recently, that of monetary policy. In today's address, I should like to talk about the challenges facing central bank communication, from a central banker's perspective.

International, and, in particular, European media and many other intermediaries play a decisive role in the process of disseminating information about the ECB's monetary policy. Media coverage of monetary policy actions is an important channel of the ECB's communication strategy, and thus an important factor for our policy's success. In the euro area, currently comprising 15 member countries (with the accession of Cyprus and Malta on 1 January 2008) and beyond, national media have retained their important role in making the central bank's actions and its objectives understood by national audiences. In my address, I will first elaborate on how central banks in general communicate, and then explain how the ECB addresses its audience.

### **How central banks communicate**

It is widely accepted today that independent central banks are best placed to maintain price stability in the economy. The Maastricht Treaty, therefore, has bestowed the ECB with full independence in the pursuit of its mandate. In a democracy, independence must be accompanied by both transparency and accountability to the general public. In other words, it is the duty of independent central banks to be transparent and to communicate not only with specialised audiences, such as financial market participants, but also with the public at large. Transparency is multi-faceted, but basically involves making information available to each interested party that is "relevant" for their understanding of monetary policy decisions.

Central banks' approach to communications has changed radically in recent years. About more than a decade ago, most central bankers believed that "secrecy" about their actions and intentions would be key to successful monetary policy.. Theoretical studies at that time suggested that secrecy and occasional "surprises" would make monetary policy more effective.<sup>1</sup> Advancements in economic and monetary theory seem to have altered this paradigm. Today, most central banks around the world accept the importance of high standards in terms of transparency and greatly emphasise the need for clarity in their communications. To give an example, it is common practice nowadays among central banks – and in particular at the ECB – to inform the public about monetary policy decisions as soon as the decision is taken. The ECB was the first to do so among major central banks in the industrialised world. This increased transparency has contributed to monetary policy effectiveness.

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<sup>1</sup> See, for example, Cukierman, A. and A. Meltzer (1986), "A theory of ambiguity, credibility, and inflation", *Econometrica*, Vol. 54, pp. 1099-1128.

The announcement of a numerical benchmark for price stability, in particular, has proven a powerful instrument to foster transparency by enhancing the public's understanding of the given central bank's objectives. In its pursuit of price stability, the ECB's Governing Council, for example, has made clear that it aims to maintain inflation rates below and close to 2% over the medium term. By announcing a quantitative definition of price stability, the ECB has provided a focal point for the formation of medium-term inflation expectations, "close to, but below 2%", and has made a significant contribution to the long-term predictability of inflation developments and monetary policy.

Central banks are prudent in their communication to always preserve their credibility in all circumstances. Let me also say that prudence in communication finds solid justification, not least, in the existence of a multitude of audiences with different needs.<sup>2</sup> Effective communication has clear benefits. First, and certainly more fundamentally, it fosters the long-term predictability of monetary policy. This helps reduce uncertainty about inflation and the costs associated with such uncertainty for consumers and investors. With its communications, a central bank can influence the formation of inflation expectations, and ensure that they remain anchored at the levels consistent with the central bank's objective. Without firm guidance on the goals of monetary policy, market participants could lose their point of reference which could result in them adjusting their longer-term inflation expectations as a mere reflection of current circumstances rather than taking into account the ability of the central bank to achieve its goal over the medium term. By contrast, in an economy in which inflation expectations are solidly anchored, each person can make well-informed financial decisions. A genuine understanding of monetary policy and its goal – price stability, and therefore the preservation of the purchasing power of the euro – also creates the best conditions for correct price and wage formation in markets, whereby all parties concerned meet their obligations and second-round effects on wage and price setting stemming from transitory price increases (e.g. oil, commodities, food) are thus avoided.

Second, effective communication also enhances short-term predictability.<sup>3</sup> Through their actions, central banks can directly control very short-term interest rates. However, given that for consumption and investment decisions the longer-term interest rates are more relevant, the whole yield curve is relevant for the effectiveness of monetary policy. Medium- and long-term interest rates largely depend on private expectations regarding future central bank decisions. Lack of effective central bank communication would eventually lead to higher, more volatile, levels of long-term interest rates, which could be detrimental to economic activity. By contrast, an environment in which the predictability of interest rate movements and their relation to key macroeconomic developments is well understood supports correct price formation in financial markets, contributes to the efficient allocation of funds, and reduces uncertainty concerning future interest rates. In such an environment, firms can improve their risk management and achieve better incentives to invest.

### **How the ECB addresses its audience**

Let me turn to how the Governing Council of the ECB explains its monetary policy decisions to the public. Our communications aim to enhance the effectiveness of monetary policy. In this respect, the Governing Council fully subscribes to the basic principles of modern central bank communication described earlier. A high degree of transparency vis-à-vis our monetary policy has helped the public to hold the Governing Council accountable for its policy

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<sup>2</sup> See Kahnemann, D. (2003), "Maps of Bounded Rationality: Psychology for Behavioural Economics", *American Economic Review*, Vol. 93(5), pp. 1449-1475, and Lohmann, S. (2003), "Why do institutions matter? An audience-cost theory of institutional commitment", *Governance*, Vol. 16(1), pp. 95-110.

<sup>3</sup> See Ehrmann, M. and M. Fratzscher (2007), "Social value of public information: testing the limits to transparency", ECB Working Paper No. 821, and the literature quoted therein.

decisions. Communication on monetary policy with a single voice is desirable and has been efficiently applied from the start of monetary union.

Establishing an effective communication policy was particularly important for a young institution that did not have its own track record, as was the case when the ECB started its operations in 1999. The ECB operates in a multilingual and multicultural environment. We have to address a significant number of audiences in each culture, the general public, opinion leaders, social partners, financial markets and, of course, the media as our partners who are key in the process of transmission of our messages to the audiences. These groups have different expectations with regard to the quantity and nature of our communications. For our communication policy to be effective, we have to make sure that our messages are transmitted in a consistent and timely manner throughout the euro area, and that there is an equal treatment of media across countries. In the presence of 23 official languages in the European Union and 13 official languages in the euro area, it is very important to ensure that the very same message is conveyed to citizens in all countries, and that appropriate translations are made.

In addition to providing these translations of the ECB's official communications in all languages spoken by the euro area countries, a number of channels are used to ensure full respect of the single voice principle. The Eurosystem-wide external communication activities of the national central banks are coordinated by the ECB. Due consideration has been given to the different cultures of communication existing in the euro area. As expected, the very diverse European national media are playing a key role in the transmission of the information to the various audiences of the ECB. Experience so far shows that the approach works well and that the media have contributed to a homogeneous understanding of the role and tasks of the ECB.<sup>4</sup>

As the "porte-parole" of the ECB and its Governing Council, I think we have shown our capacity to communicate in unison with a high level of team spirit in interaction with a highly sophisticated and complex media network dealing with 320 million European citizens speaking 13 languages.

It must be underlined that the European Central Bank decided from the very beginning to embark on a bold concept of transparency. On 1st January 1999, at the moment of the start of the euro, the state of the art of central banking was, not to say anything immediately after each decision on monetary policy, let observers and markets guess what had been the reasoning of the central bank and publish five or six weeks afterwards, the reasons why the decision was made in the form of "minutes of the decision-making college". We decided from the first day of the euro that we would have a significantly higher level of transparency.

First, we thought it was necessary to give to the public the economic and monetary diagnosis of the Governing Council, and the reasons why the monetary policy decision was taken, immediately after the meeting. This quasi real time display of the detailed reasoning of the Governing Council took the form of five to six pages of "introductory remarks".

Second, we considered it to be useful to give additional explanations to the media, to market participants and to the general public in the form of a press conference that would take place immediately after the Governing Council and would be introduced by the "Introductory Statement".

The ECB, in so doing, contributed to a significant change in the state of the art on transparency of central banking. Today central banks are more often giving real time information on their decisions, generally in the form of explanatory communiqués that are published immediately with the decision. We remain nevertheless quasi unique amongst

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<sup>4</sup> See Berger, H., M. Ehrmann and M. Fratzscher (2006), "Monetary Policy in the Media", ECB Working Paper No. 679.

major central banks in publishing a detailed analysis in quasi real time and in having a press conference.

Why were we so keen to introduce a new and bold concept of transparency? I think we had three main reasons:

Firstly we had to consider that we were launching a new currency to which we had to transfer the full legacy of stability, of confidence, of credibility which was the characteristics of the most credible previous national currencies. The Maastricht Treaty had been entirely based upon this benchmarking concept. And our goal, in the moment of the transition, was to fully respect the promise made to the people of the euro area namely: "The new currency will be at least as credible and as confidence inspiring as was your own national currency." In this perspective it was very important to explain in real time our decisions to be as clear as possible on our diagnosis and reasoning with a view to convince observers that the new currency deserved fully this very high level of credibility.

Secondly we also had to take into account the fact that we were issuing a new currency for eleven countries, eleven cultures and (soon to become twelve and then later on thirteen and fifteen today) and many languages. In this framework it was indispensable to have extremely clear single terms of reference from the very moment of the collegial decision. Otherwise it would have been unavoidable that various interpretations would have been given through the grid of various cultures and different languages. Had we waited for five or six weeks to give detailed explanations we would have been facing information and communication issues that would have been very difficult to solve.

Thirdly, as explained before, and totally independently of the previous two reasons which are specific to the euro area, academic research had, particularly in the 90's, made important advances in permitting to understand better the decisive role of transparency in establishing and consolidating the credibility of central banks and in helping them to solidly anchor inflation expectations.

Let me tell you in concluding these short remarks, in front of so many eminent representatives of German media, how much precisely we rely upon you for our communication with the general public, with all our fellow citizens. It is extremely important of course for a central bank to have an effective communication with market participants, investors and savers in Europe and in the world.

For the European Central Bank, and its Governing Council, which is the guardian of the currency for 320 million people, it is to the public at large that we are accountable. Therefore communication with the general public is decisive, for it to be sure that it is well informed of our diagnosis, our analysis and our decisions.

We met in the Governing Council last Thursday and I explained fully on behalf of the Governing Council what are our present views and orientations.

Let me sum up the core message of the Governing Council of the ECB to our fellow citizens:

- We are responsible for delivering price stability – namely inflation less than 2%, close to 2% – in the medium run. It is our Treaty mandate. It is what the people want.
- We presently have inflation higher because in particular of oil, commodities and food price increases and the effect of indirect taxes.
- For inflation to go down, back to our definition of price stability it is essential that we do not have prices and labour costs spiralling taking into account the present level of inflation and giving rise to what we call "second round effects". All decision-makers whether private or public, including entrepreneurs and social partners should have that in mind all over the euro area.

- Decisions of augmentation of prices and costs that would depart from this recommendation would do nothing but contributing to higher inflation, diminishing purchasing power in the medium run, diminishing competitiveness and therefore hampering durably the job creation process which is presently a major success of the euro area.

I thank you for your attention.