# Jörg Asmussen: Building trust in a world of unknown unknowns – central bank communication between markets and politics in the crisis

Speech by Mr Jörg Asmussen, Member of the Executive Board of the European Central Bank, at the European Communication Summit 2012, Brussels, 6 July 2012.

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Ladies and Gentlemen,

It has been said that "*there have been three great inventions since the beginning of time: fire, the wheel, and central banking*"[1]. Central banking has become my business since January this year, but I feel I am getting my fair share of the other two as well: being behind the steering wheel of the ECB during this crisis turned out to be in the line of fire.

You invited a central banker to speak at this year's European Communication Summit. Thank you for giving me the opportunity to share some thoughts with you on a very relevant topic: central bank communication in the crisis.

Communication is an essential and powerful policy tool of central banks. This is because the physical "product" of a modern central bank is something with little intrinsic worth. The euros in our pockets are, after all, only pieces of printed paper. Their value lies in the shared conviction that this so-called fiat money can be used as a means of exchange, as a unit of account and above all as a store of value. "*All money is a matter of belief*"[2].

This belief stands and falls with the credibility and trustworthiness of the central bank. This, in turn, rests on its words and deeds.

Maintaining this trust is an enormous responsibility. Consistent communication and policy action can create confidence and popular support. By contrast, miscommunication and policy mistakes can create excessive volatility in markets. In extreme cases, the currency itself may be at risk. And with it the value of the peoples' savings.

It was not always obvious that central banks and communication should be mentioned in the same sentence. Central banks used to be secretive places. They used to surprise the markets with their policy moves. They used a language that made the oracle of Delphi appear positively accessible: Alan Greenspan is on record as saying: "*If I seem unduly clear to you, you must have misunderstood what I said*"[3].

Those days are over. Central bank communication has become a very dynamic discipline. By deliberately steering expectations in financial markets with their communication, central banks let the markets do part of the job of transmitting their policy signals.

The crisis was a game-changer in the communication of central banks, and of economic policy makers more generally. In this world of unknown unknowns, and rapid shifts market sentiment, our task has become much more complex. The new challenges can be captured by the following three themes, or fault lines:

- First: market communication *versus* political communication;
- Second: transmitting the message *versus* facing the discourse
- Third: arguing with counterfactuals and navigating the short *versus* the long term

I will address each of those in turn.

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[1] Will Rogers, cited by Paul Samuelson

[2] Adam Smith

[3] Wall Street Journal 22/09/1987

## 1. Market communication vs political communication

In the "old" days, central bank communication was focused on a specific target audience: financial markets, specialised financial media, interested academic circles. It was an "insiders' community", speaking an expert language.

Anyone who listened to speeches of central bankers on the economic outlook and the course of monetary policy knows what I mean: they were deliberately unexciting, technical and repetitive. But this type of communication inspired confidence: there was a consistent message and a steady hand at the tiller.

The importance of the consistency of the messages across time, countries and media outlets remains. But the context has changed fundamentally. During this crisis, central bankers and policy-makers are faced with a potentially explosive interplay between markets and politics. Messages that are necessary and legitimate in public debates can be completely unsuited for market communication and exacerbate tensions.

Let me explain. In spring 2010, Angela Merkel addressed the German Bundestag to persuade lawmakers to approve the financial assistance programme for Greece. She had to engage in a profoundly *political* discourse. She employed all tools of rhetoric. And she justified her appeal by declaring that "*the future of the euro is at stake*". This was legitimate.

However, in financial markets across the globe, that very same message popped up on traders' screens as a one-liner: "*Merkel questions survival of single currency*". If you were a trader, what would you do? The rest is history.

One and the same message is received very differently by different audiences. But those audiences cannot be separated easily. "Political" communication and the processing of this information in nervous and fragile markets has been a major factor that exacerbated and propagated the crisis.

We still do not have an answer how best to bridge this gap: on the one hand, we must not suffocate open debate in our democracies. We cannot muzzle the public discourse to impose conformity with the needs of nervous markets. At the same time, undisciplined and irresponsible communication has real, costs.

Maybe one way forward would be to emphasise that markets should listen to the right kind of statements. If it concerns the euro area as a whole, it is the voices of the supranational level that should count.

Markets should also concentrate on what is *actually being said* by policy-makers, rather than how this is being interpreted by analysts, commentators and the media. The constant extrapolation of what current policy decisions "could" or "are likely" to imply under extreme scenarios sows the seeds of volatility. The focus on what *might* happen in case of catastrophic tail-events diverts attention from already achieved or agreed policy action.

A second aspect of the "brave new world" of communication is the urgent need to communicate beyond the specialist "insider's circle". Central banks have to actively communicate with the broader public, for three reasons:

- First, what used to be obscure and complex issue for monetary policy specialists are now mainstream news. Two years ago, few people had heard of central bank operations or intra-Eurosystem payment flows. These days, television talk shows debate the ECB's long-term refinancing operations or TARGET2-balances. The people have a legitimate interest and a right to get information and explanation directly from us, rather than via intermediaries.
- Second, in all of this, we are faced with the inevitable tendency to reduce complexity and simplify the message. This is what the media are supposed to do: "*First simplify,*

*then exaggerate!*"[4]. Simplification is, of course, legitimate – and also needed. But exaggeration is not. It risks skewing perceptions and distorting the true picture of the situation. Take, for instance, the situation in Ireland or Portugal. This requires comprehensive and in-depth understanding – an analyst's two-pager often cannot do justice to this complexity. By sharing and explaining its own assessment, the central bank can contribute to a more balanced debate.

- Third, during the crisis, the ECB has undertaken extraordinary measures. It has provided 1 trillion euro in liquidity to the banking system. It contributes to the design of adjustment programmes for countries receiving EU-IMF assistance. It is part of the Troika going on country missions. It offers advice on the future evolution of Europe. Some criticise us for this, some claim that we go beyond our mandate. Those criticisms must not go unanswered.

Adding complexity to an already complex situation is the fact that the ECB communicates in a multi-lingual, multicultural context. One and the same message, even if translated perfectly into the 23 official EU languages, may cause very different public and market reactions.

But extraordinary actions call for extraordinary efforts to explain them. This brings me to my second point:

## 2. Transmitting the message *versus* facing the discourse

In the past, central bank communication was mainly a one-way street. The central bank transmits its messages. As independent institutions, they were – and continue to be – prohibited from yielding to outside influence. And rightfully so. The first President of the ECB, Wim Duisenberg, summed it up very neatly: "*I hear, but I do not listen*"[5]. The academic debate about central bank communication focused on transparency: Whether central banks were too closed and provided too little information.

The globalisation of information, the rise of the internet and the new "prominence" of central bank action create a new context: whatever the central bank does is subject to a worldwide market assessment and media commentary.

In blogs and internet comments, via Twitter, on TV channels and in traditional print media, central banks are faced with a barrage of outside opinion that has a powerful impact on public discourse. Professors, Nobel Prize winners, analysts, chief economists, innumerable experts, any individual posting comments on the internet: they all present their analysis and opinion.

In many cases, there is thoughtful analysis. In some cases, opinionated polemics. But in almost all cases, they know better. The concepts they use, the solutions they propose and the policy actions they call for – all this shapes the public discourse, and one way or another also influences policy-makers.

The difference is that commentators do not need to assume the responsibility for the recommended actions. Policy-makers have to.

Let me give you an example: last year, a debate was raging about the size of the European financial assistance facilities, the so-called "Eurozone firewall". None of the very substantial amounts seemed to be enough: the 500 billion euro that were already on the table, and used to only a very small extent, were decried as insufficient. One trillion euro at least, if not two trillion or more, were seen as necessary.

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[4] Instruction of an editor of The Economist to his newly recruited reporters

[5] ECB press conference 11/04/2001

One idea pushed forcefully by the "international expert opinion" was to "leverage" existing funds, by offering incentives to private and public entities to provide additional funds. And indeed, throngs of European officials worked night and day to devise and agree on two options to leverage the European Financial Stability Facility (EFSF). Today the two instruments are there. They could work. Will they ever be used? The caravan of the "commentariat" had already moved on. No-one speaks about leveraging the EFSF anymore. In fact, the actual investors in EFSF bonds were put off by the leveraging options, because it made the EFSF structure more risky and less understandable.

The searchlight of attention of the markets and the commentary shifts fast. Yesterday it was the firewalls. Then it was growth. Today it is Spain. For sure, all of these issues require action. But designing and agreeing on responses takes time. No wonder that policy-makers are criticised for constantly being "behind the curve".

Markets want to see immediate and forceful action from Europe's politicians. And their criticism of the slowness of the European crisis response is in part justified. But democratic politics takes time. It is open, noisy, and messy. We cannot do "crisis management by Politburo". We need effective communication and a proper public debate. This is especially true for the envisaged next steps towards deeper integration in Eurozone.

Why am I telling you this? Because it sheds light on the nexus between a new class of opinion formers, financial markets and policy outcomes.

For the euro area and the ECB, the situation is even more peculiar, because the influential "commentariat" comes predominantly from *outside* the euro area. The big English-language newspapers, the news agencies and wire services that shape opinions in the economic and financial sphere on the Continent are all writing from outside the euro area. There is, of course, nothing wrong with friendly outside advice. And I certainly do not wish to come across as whining and complaining.

But it simply remains a fact: the analysis, discourse and policy prescriptions that are propagated come from the outside. Maybe inevitably, they come with a certain disinterested detachment. As if the outside "spectators" are not affected by what is happening.

And they come with a dangerously narrow and exclusive perspective on the economics of the monetary union. But if the profound *political* commitment of Eurozone countries to the historical project of "ever closer union" is neglected, the assessment remains superficial and partial. And the suggested policy responses may be biased or naïve.

Why does it matter? Because the discourse influences some of the most important financial markets for the Eurozone. If expectations that have been built up are not fulfilled, if alleged certainties do not materialise, if actions from politicians or central bankers are not forthcoming as anticipated by the "market consensus", the reaction can be grave: volatility, contagion, all the way to complete market dysfunction. The systemic impact can be major, driving financial institutions, as well as sovereign borrowers into real difficulties.

The result is a situation where policy-makers – including the central bank – may feel compelled to react to market developments with ever more powerful responses, in order to contain the a systemic risk and avoid a meltdown.

What is the lesson? Central banks have to face up to the public and market discourse – especially because they are independent. We have to participate in this debate. We have to take on the critics, understand their points, and argue our case. We have to listen, explain, and convince.

Naturally, we will ultimately do what we judge to be the correct cause of action, in full independence and in line with our mandate. Actions speak louder than words. Especially when they are timely, measured and effective. This is what creates confidence.

Precisely for that reason, financial markets, as well as politicians, have been looking to the ECB as a kind of "saviour of last resort". This creates maybe an even bigger communication challenge: we must explain what the limits of our powers and mandate are. The ECB cannot compensate for what others – notably political authorities – fail to do. There is no substitute for good policies. Saying this is not always popular. But "*to be trusted is a greater compliment than being loved*"[6].

When market pundits forecast the "inevitable", they insinuate a degree of certainty about the future which is simply not there. This brings me to my last point – how to deal with uncertainty, with a world of unknown unknowns. And how to communicate when everyone asks "what if".

## 3. Arguing with counterfactuals and navigating the short *versus* the long term

During this crisis, the ECB has taken a number of non-standard measures. They were, by definition, out of the ordinary. But they were motivated by the need to prevent a catastrophe. What we did, we justified with respect to an intangible counter-factual. With respect to history that did *not* happen. Doing so can be extraordinarily difficult.

Let me give you an example. Back in November 2011, we were faced with acute tensions in financial markets; entire market segments had become dysfunctional. The danger of a credit crunch was real. There was an anticipation of an inevitable catastrophe. You may remember the headlines: "*The euro has a 50% chance of making it to Christmas*"[7], or "*Ten days to save the eurozone*"[8].

The announcement of our long-term refinancing operations was a sentiment changer. The feared severe credit crunch has not materialised. The euro is still here – and here to stay. But the question "what if the ECB had not acted" remains unanswered. There is no evidence what would have happened in such a counterfactual. This makes justifying our action with reference to such a counterfactual an uphill struggle.

The uncertainty embedded in the "what if" question is exacerbated by the discontinuity between the short term and the longer term in the interaction between markets and policy-makers. Let me explain.

Markets mainly focus on the immediate future; on the emergency measures to fight the crisis: here, a central bank can be very effective. The ECB can change the market situation within minutes, by adjusting its interest rate, market interventions if needed, adapting its collateral rules, or simply communicating its assessment. This creates certainty, for now.

However, for the longer-term, considerable uncertainty remains: short-term fixes do not change the structural features of European economies and markets. Those depend on the countries' economic policies, which take time to design and implement. Firm commitments from governments can help reduce this uncertainty, but can never eliminate it.

The trade-off between the short term and the long term creates a fundamental communication challenge for the ECB. If short-term crisis fighting is successful, for instance through ECB actions, some of the longer term challenges might never be addressed. The immediate pressure subsides, and incentives for governments weaken. More than once did we witness this during this crisis.

By contrast, if the fire-fighting in the short-term does not succeed, there may not be a longer term to think about.

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6 George MacDonald, 19th century Scottish writer

7 Jacques Attali 26/11/2011

8 REUTERS, 30/11/2011

Our communication is walking a tightrope: markets need reassurance that the ECB will do what is within its power and mandate to guarantee that the euro will not to fail. At the same time, governments need to have the right incentives to tackle the longer-term challenges.

## Conclusion

Ladies and Gentlemen

The crisis was a game changer in the communication of central banks. Navigating between markets and politics has shifted the goalposts of the ECB's communication. We are facing up to this new environment and its challenges. We are engaging more. We are explaining more.

The changed environment, including the spread of new media, might actually be an opportunity in this respect. That said, I would not expect every member of the ECB Governing Council to open a twitter account soon or to accept you as friends on Facebook.

Let me close with a word of caution. The ECB has gained stature during this crisis. The people and the markets look to the ECB for solutions. But there should be no illusion that the ECB can single-handedly ensure a plain sailing for our economies and the markets. There are limits of what we can do, and what we know. "*Central banks do not have divine wisdom. They try to do the best analysis they can and must be prepared to stand or fall by the quality of that analysis*"[9].

Rest assured that we will continue to do this, and to fulfil our mandate. Not least to make sure that central banking remains up there in the list of the three greatest inventions.

Thank you very much for your attention.

[9] Eddie George, former Governor of the Bank of England