Mugur Isărescu: Central bank communication as a policy tool - an ongoing challenge

Speech by Mr Mugur Isărescu, Governor of the National Bank of Romania, at "The 41th Meeting of the Central Banks Governors' Club of the Central Asia, Black Sea region and Balkan countries", Istanbul, 25 March 2019.

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As prepared for delivery

Distinguished audience,

Dear colleagues,

It is a great pleasure for me to address this distinguished panel on a topic that is both important and challenging for central banking. The session's title includes three key issues: effectiveness, knowledge and trust, all in relation to the manner in which central banks communicate their policies and actions.

I would like to share with you some general thoughts regarding these issues, as well as the National Bank of Romania's experience in this area over the recent years.

More transparency, commitments too

Views and practices concerning transparency and communication have evolved dramatically in the last decade. Not long ago, the conventional wisdom was that monetary policymakers should say as little as possible, take markets by surprise and be rather cryptic. Things have changed, as the more independent central banks also became accountable for the 'public goods' they were called to provide for: a credible and convertible currency, price stability, employment and growth in other cases, banking sector supervision and financial stability. People tend to take these 'public goods' for granted, appreciating their importance only when lost.

Clear communication of the central bank's objectives, policy strategy and its decisions proved essential to anchoring inflation expectations and enhancing monetary policy effectiveness. However, most research works in this area show that **increased transparency is not enough. A central bank must demonstrate commitment and ability to achieve its objectives through a systematic implementation of its policies**. The markets and the public at large need to be convinced by central banks through consistent and effective words and policy actions, formulated as plainly as possible, in order to **build knowledge and confidence** – all vital for an effective management of public expectations.

Despite a growing recognition of the importance of transparency in monetary policymaking, no consensus has emerged yet – either among academics or central banks. There is still debate on what is the appropriate degree of transparency or the best communication path, so that the two factors can contribute to an effective achievement of policy objectives as well as an efficient market functioning. The 'best practice' in the field depends, inter alia, on the size, structure and complexity of the economy, its global interlinkages and policy cycles, the monetary policy objectives and strategies, the political environment and institutional framework of a particular central bank, as well as on the extent and nature of uncertainty faced by policymakers.

When assessing communication, one should take into account various economic, political and institutional factors in addition to the elements of uncertainty a central bank faces, no matter how modern the communication tools it employs. Thus, central banks may implement, successfully, different communication strategies that may be appropriate and optimal given the abovementioned factors.

As most central banks, including the National Bank of Romania, have opened up a lot in recent years – by reviewing, adapting and refining their strategies, using modern and social media tools –, **an effective communication approach should always include a degree of flexibility** in order to respond to a rapidly changing economic environment, exceptional circumstances as well as the level and appetite for financial knowledge in the society.

Forward guidance

The global financial crisis pushed central banks to expand and heavily use their monetary toolkits besides identifying new instruments for the more delicate financial stability area. One weapon in their arsenal, involving a strong communication approach, was **forward guidance**, which was put to good use in the monetary policy field as central bankers attempted to calm the markets.

Wisely exploiting the power of words, forward guidance was aimed at improving monetary policy transmission by offering more than just a glimpse at the central banks' next moves. Greater predictability of the reaction function or an associated timing for the next actions enable market participants to better calibrate expectations. It worked in several instances.

It also increased the initial framework to include, apart from the traditional policy rate, references to some other parts of the central bank's toolkit (asset purchases), offering markets nice hooks to cling on in times of stress and heightened uncertainty.

Was this a too adventurous path to embark on? The toughest challenge for monetary authorities, as financial markets become too addicted to central bank guidance, is to identify smart ways to communicate in due course how and in which manner the shift to normalisation will take place, while also clarifying the limits of their actions and influence. All for a pretty good reason: avoid a possible addiction crisis that could in itself lead to turmoil and volatility.

The real test for forward guidance is not the manner or techniques used to disseminate information, it rather occurs when the forward guided policies are implemented. That is the point where the actions meet or not the expectations fuelled beforehand. Forward guidance relies on the central banks' credibility, validated in time by matching its commitments, a quick adjustment of messages, clear accountability for forecast errors and even for misjudgements. It is also important to explain the context in which they operate.

In monetary policy communication, the guidance of expectations, constant explanations and educational projects have been building knowledge and trust. Financial stability is a more sensitive area, though. Central banks often come across different views of other public actors: authorities, governments or parliament members.

Post-truth environment

In a world of uncertainty, with incomplete information about the prospects and state of the economy, information about central banks' strategy is a necessary, although insufficient, condition for the general public and market participants to understand decisions and shape their expectations.

A careful calibration of wording is needed, along with greater efforts to explain the role and limits of central banks in the financial field, in order to secure confidence. All this becomes even more challenging given the fast-moving, **'post-truth' environment plagued by populism**. As impatience has filtered in many domains, an erosion of confidence in the independent, accountable public institutions has emerged, as did the risk of exposure to swings in the economy, due to a change in sentiment.

To cope with this, central banks across the globe have boosted their efforts to educate, increase financial literacy, outreach and dissemination capacities, while trying to deal with the growing challenges related to fake news and negative campaigns.

I would like to draw your attention to **some recent, new tools – first, an ECB educational product called 'Visitor Centre...to Go'** that briefs in plain language the institutions' key messages and knowledge in an easy-to-carry format – a suitcase! Any ECB expert can use this kit during visits to schools or universities. Secondly, an interesting way to counterbalance fake news campaigns is the one used by the central bank of Ukraine – winner of 2019 Central Banking Publications award for transparency. They created a page on their website as well as infographics, with simple and relevant data, to dismiss fake news about local banks as the sector was struggling with a critical situation.

Therefore, effective central bank communication for the whole spectrum of its policies is an ongoing challenge.

The National Bank Romania's experience

As regards the National Bank of Romania, one key challenge to policy communication effectiveness concerns the apparent **divergence between actual inflation and that perceived by the public**. In a country that saw annual inflation running at 300 percent back in the 1990s and succeeded to tame prices in the single-digit zone for over more than a decade, this divergence **has gradually declined**.

This issue has steadily been in our focus. In 2005, two years before Romania's EU accession, the shift to a flexible inflation targeting strategy and redenomination of the local currency brought about more discipline in communication and transparency. Thus, **regular media briefings (almost every six weeks), more specialised publications, as well as educational materials, conferences and seminars, livestreams and online tools, dedicated outreach projects which put at good use our territorial network, increased social media presence with tweeting, videos, tutorials and educational games or blogging (actually, we were among the pioneers in blogging) became part of the National Bank of Romania's standard communication practice**.

The diversification of instruments and audiences came in swiftly. Some steps came only recently (2016) – amid fears of misleading or misunderstanding by the general public that was yet to grasp the very essence of the banking and financial business, not to mention central bank activities –, such as publishing the summary of accounts of monetary policy meetings and the pay thresholds or even regular parliamentary presence. As Romania's financial literacy is the lowest among EU Member States, the **National Bank of Romania has devoted special energy to promoting financial knowledge** across the country via educational projects in cooperation with the Ministry of Education, universities, academia or other authorities.

As regards the forward guidance, I have to say it was not among the preferred options given the specifics of monetary transmission mechanism in Romania, where the struggle was to cope with high currency substitution amid harsh transition from a controlled economy to functional markets and with large capital inflows on the eve of EU accession. Our policy statements such as the *Inflation Report*, the *Financial Stability Report*, the *Annual Report*, besides our regular briefings, conferences or interviews have always offered clear perspectives.

Nevertheless, as negative inflation numbers, short lived in our case, popped up, I believe it is important to deepen our understanding and address the causes of the public misperceptions regarding the divergence between actual inflation and that perceived by the public in order to build and strengthen confidence.

With inflation tamed in the single-digit zone and the Romanian leu fully convertible, the National Bank of Romania's increased transparency helped to boost the positive perception, strengthening our reputation.

On the flipside however, oversized expectations have also emerged, with people demanding answers and solutions from us to all the problems in the economy, hoping that the National Bank of Romania, like all central banks, could make up for the policies that naturally belong to other institutions.

People worry about price moves; a rise will boost emotions although today's puzzle lies with prices' stubbornness to stay too low for so long. But money loss gives them more shivers, pushing most into dire straits when that risk materialises. **In an emotional and fretful environment, any message about the safety of our pockets – the essence of financial stability – may be easily distorted, thereby fanning fears**. Sometimes, central bankers' talk seems too strong, on other occasions too vague for both markets and the public at large.

Confronting volatility, uncertainties, mistrust or even panic and scepticism only via the monetary toolkit is not enough. Central bankers are struggling to address some of these issues, to make them understood by using all the modern and persuasive communication methods or tools. Nevertheless, their effort is poorly matched by the fiscal policy and by the often delayed structural reforms.

In our case, as the global financial crisis unfolded, it took a while until the loss of confidence in the main actors of the financial industry filtered in to also affect the National Bank of Romania. Thus, a few years ago, **the public perceptions started to be influenced by local fake-news campaigns echoing the 'post-truth era' that pointed to the NBR as being 'the banks' lawyer'**.

Moreover, as loose or uneven fiscal moves or reckless legislative initiatives hindered the efficiency of the overall macroeconomic policy mix in Romania, the central bank openly voiced its concerns regarding the sustainability and impact on growth potential of such populist measures, triggering harsh criticism from their promoters.

The global crisis proved once again that **price stability cannot be achieved in the context of financial instability, whose resolution calls for far more than monetary policy words and deeds and by far more knowledge and confidence**.

Austerity measures, the recession, slower-than-expected recovery, along with **the view that the banking sector alone is to be blamed for these misfortunes – even though in Romania, unlike elsewhere, no bail-outs were resorted to** – created a mood that eroded the high prestige that the National Bank of Romania had enjoyed prior to the crisis. A reputation that had been earned thanks to a more transparent, flexible, effective policy and to a greater openness to the general public. We were not alone. That sentiment became mainstream across the globe, as well.

Central bankers are nowadays cornered to deliver more in their countries, to actively punish the offenders of fiduciary and prove more empathic with debtors and, why not, more compliant and tolerant with populist measures that affect the financial sector and macroeconomic stability. Otherwise their independence would be put at risk, as it is already challenged by public representatives.

Given the rapid change in perceptions in a 'post-truth' environment, with few impartial media and the increase in populism, most central banks across the world, including the National Bank of Romania, may face a possible delay in recovering the public trust to the pre-crisis levels. Even if they spoke more plainly or loudly, using all the modern communication toolkits, the slow bridging of the trust gap should not crush the contribution of independent central banks to the efforts to avert crises, achieve economic progress and be an open and responsible institution in the society. And, in the National Bank of Romania's case, its legacy is an important pillar of Romania's modernisation.