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CB communication policy

An overview of research and policy

Jakob de Haan
Head of Research DNB,
Professor of Political Economy, University of Groningen

CB communication (1)

- Central bank communication can be defined as the provision of information by the central bank regarding such matters as the objectives of monetary policy, the monetary policy strategy, the economic outlook, and the outlook for future policy decisions (Blinder et al., 2008).

Table 7. The role of central bank communication during the crisis

	Governors	Academics	Chi-sq.
CB has communicated with the public... (N_G=54, N_A=158)			15.6**
Much less	0.0	3.2	
Somewhat less	0.0	0.6	
No change	14.8	3.2	
Somewhat more	33.3	53.2	
Much more	50.0	38.6	
Difficult to say	1.9	1.3	

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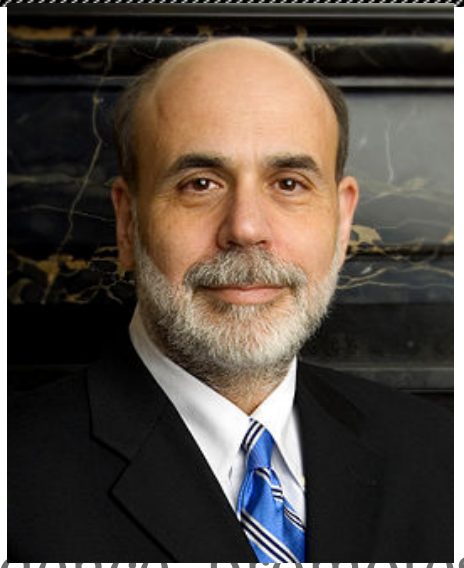
Communication after the crisis

Table 8. The role of central bank communication after the crisis

	Governors	Academics	Chi-sq.
The crisis-related changes in central bank communication will... (N_G=44, N_A=114)			6.4
Revert back completely	2.3	1.8	
Revert back somewhat	11.4	16.7	
Remain	50.0	55.3	
Go even further	20.5	21.9	
Too early to judge	15.9	4.4	

CB communication (2)



Bernanke: “when I began my time as Chairman, one of my priorities was to make … monetary policy as transparent and open as reasonably possible. … transparency in monetary policy enhances public understanding and confidence, promotes informed discussion of policy options, increases the accountability of monetary policymakers for reaching their mandated objectives, and ultimately makes policy more effective by tightening the linkage between monetary policy, financial conditions, and the real economy.”

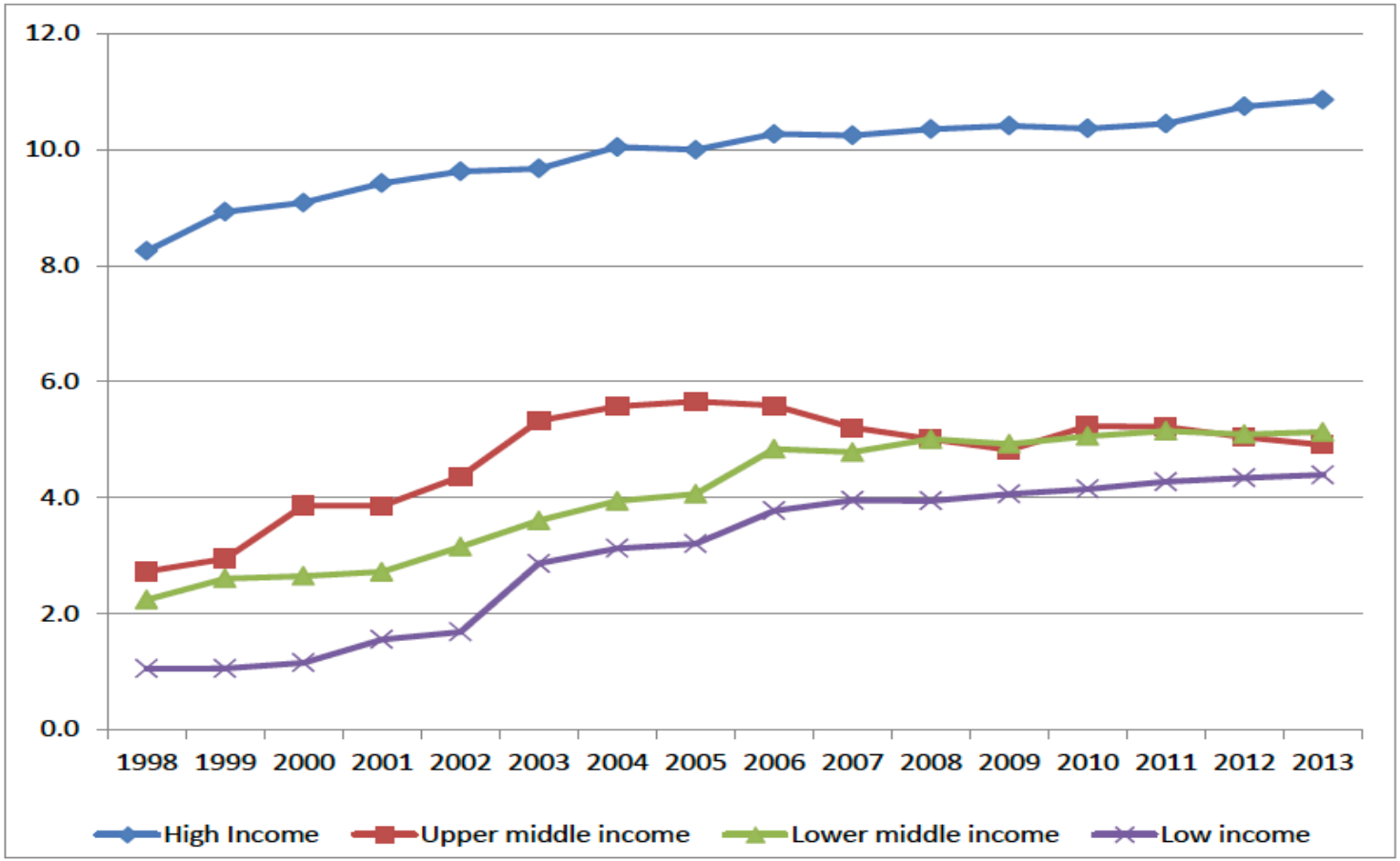
CB communication (3)

➢Communication can reduce noise in financial markets increasing predictability of policy

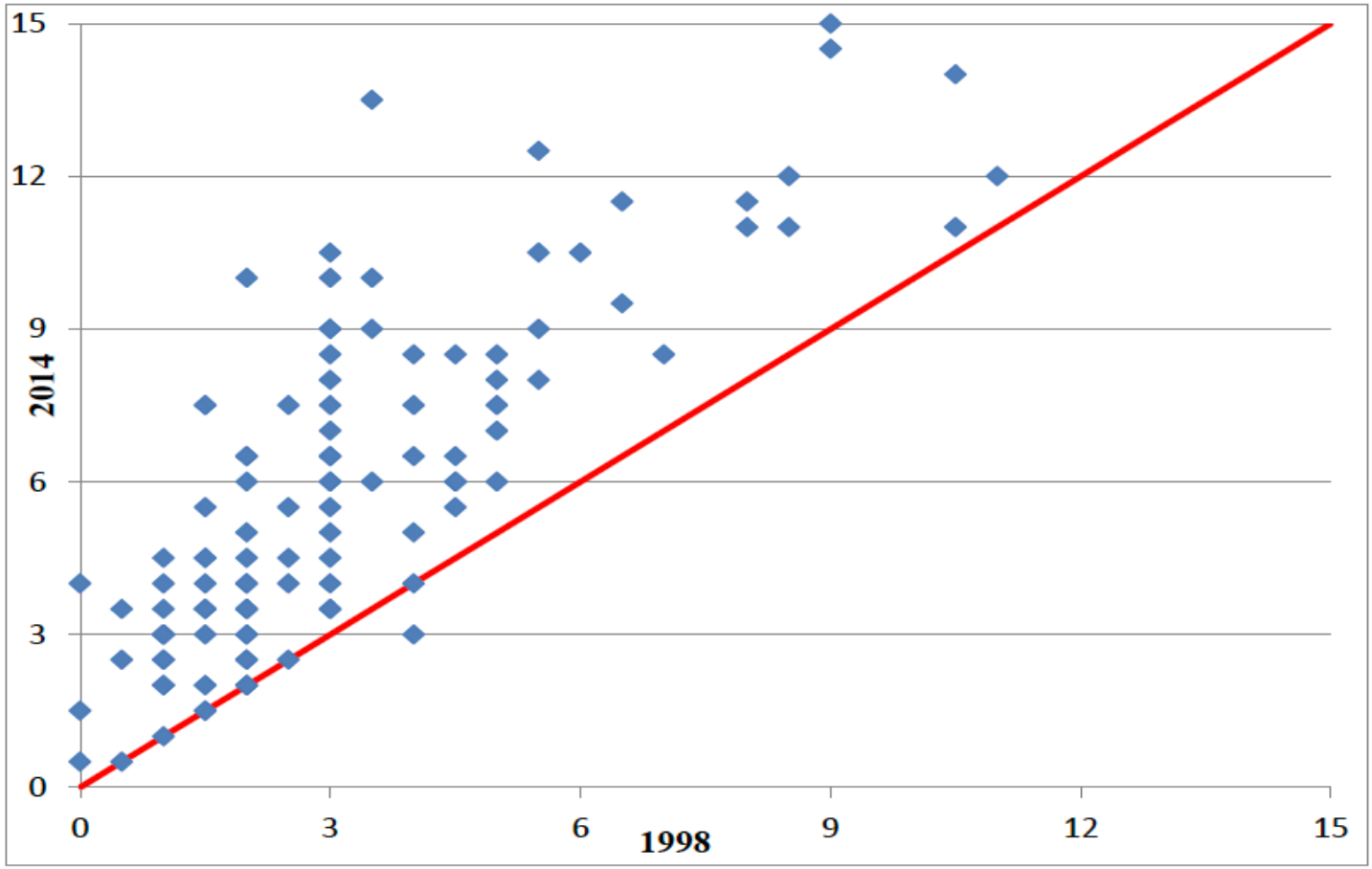
➢Communication is also considered as an additional instrument for policy makers

➢Increased due to need for independent central banks to be transparent and accountable

CB Transparency (source: Dincer-Eichengreen)



CB Transparency (source: Dincer-Eichengreen)



Example: Fed (1)

- February 1994: Federal Open Market Committee (FOMC) started announcing its decisions on the federal funds rate target.
- May 1999: FOMC began publishing an assessment of its "bias" with respect to future changes in monetary policy in its statements.
- Greenspan ("mumbling with great incoherence") was by 2003 explicitly managing expectations by telling everyone that the Fed would keep the federal funds rate low "for a considerable period."

Example: Fed (2)

- About three years later, it began announcing FOMC votes—with names attached—immediately after each meeting.
- February 2005: the FOMC expedited the release of its minutes to make them available before the subsequent FOMC meeting.
- January 2012: Fed announces inflation target.
- January 2012: Fed publishes "dot plot" which provides members' assessments of "appropriate monetary policy."

CB communication (4)

- Communication to whom and why:
  - Government and parliament (accountability)
  - Financial markets (predictability, effectiveness)
  - Public (accountability, effectiveness)
- Communication about what:
  - State of the economy
  - Current and future monetary policy
  - May have different effects

CB communication (5)

- Communication how:
  - Press release and/or press conference
  - Minutes of meetings (with/without voting record)
  - Official publications (like Annual Report, Inflation Report, Economic Bulletin)
  - Speeches or interviews
  - Testimonies in parliament
- Markets react differently to different communication devices and this differs across CBs.

CB communication (6)

- Communication: the receiver. De Haan et al. (2004): substantial differences between newspaper reports on ECB policy decisions in the *Financial Times* (*FT*) and the *Frankfurter Allgemeine Zeitung* (*FAZ*). The British-based *FT*, which is critical of the money growth pillar in the ECB's monetary policy strategy, tends to pay relatively little attention to it. In sharp con-trast, *FAZ* clearly supports the idea that money should have a prominent role in the ECB's strategy, and accordingly gives that pillar substantial attention.

Measuring CB's communication policy (1)

- CBs communicate about: objectives and strategy, motives behind a particular policy decision, economic outlook, and future monetary policy decisions.
- To analyse whether CB communication enhances predictability and effectiveness of monetary policy it needs to be measured.
- There are several ways this has been done in the literature.

Measuring CB's communication policy (2)

- Essentially four approaches have been developed to measure (the effects) of central bank communication.
- Various studies have examined the effects of central bank communication events on the volatility of financial variables.
- Focusing on volatility makes it unnecessary to assign a direction to each statement. The most important weakness of this approach is that it cannot assess whether markets moved in the "right" direction.

Measuring CB's communication policy (3)

- In the second approach communication is quantified in order to assess both the direction and magnitude of its effects on asset prices—and thus to determine to what extent communication has its intended effects.
- Communications must be classified according to their content and/or likely intention, and then coded on a numerical scale. Negative (positive) values are assigned to communications that are perceived as dovish (hawkish), and zero to those that appear to be neutral.
- Weakness: necessarily subjective, and there may be misclassifications.

Example: Ehrmann and Fratzscher (2007)

The final step consists of classifying the inter-meeting statements into those that give an inclination of tighter monetary policy versus no change or lower interest rates (C^{MP}),[3] and accordingly for the economic outlook (C^{EC}):

$$C_t^{EC} = \begin{cases} +1 & \textit{stronger econ.outlook} \\ 0 & \textit{unchanged econ.outlook} \\ -1 & \textit{weaker econ.outlook}, \end{cases}$$

$$C_t^{MP} = \begin{cases} +1 & \textit{tightening inclination} \\ 0 & \textit{no inclination} \\ -1 & \textit{easing inclination}. \end{cases}$$

Measuring CB's communication policy (4)

- Third, in the approach first suggested by Gürkaynak *et al*. (2005) and Gürkaynak (2005) and also implemented in Brand *et al*. (2006), indirect measures derived from financial market reactions are employed.
- Finally, more recently several papers have used text mining software to distil the messages and/or the the tone of the communication.

Measuring CB's communication policy (5)

- Example: Carvalho et al. (2016) examine the effects of Federal Reserve communication on medium- and longer-term interest rates. They use textual analysis of newspaper articles in Factiva around each FOMC announcement to measure the perceived change in the Fed's "hawkishness" or "dovishness". They show that their text-based measure of Fed communication had economically and statistically significant effects on 2-, 5-, and 10-year Treasury yields throughout the 2008–15 ELB period.

Enhancing predictability of policy (1)

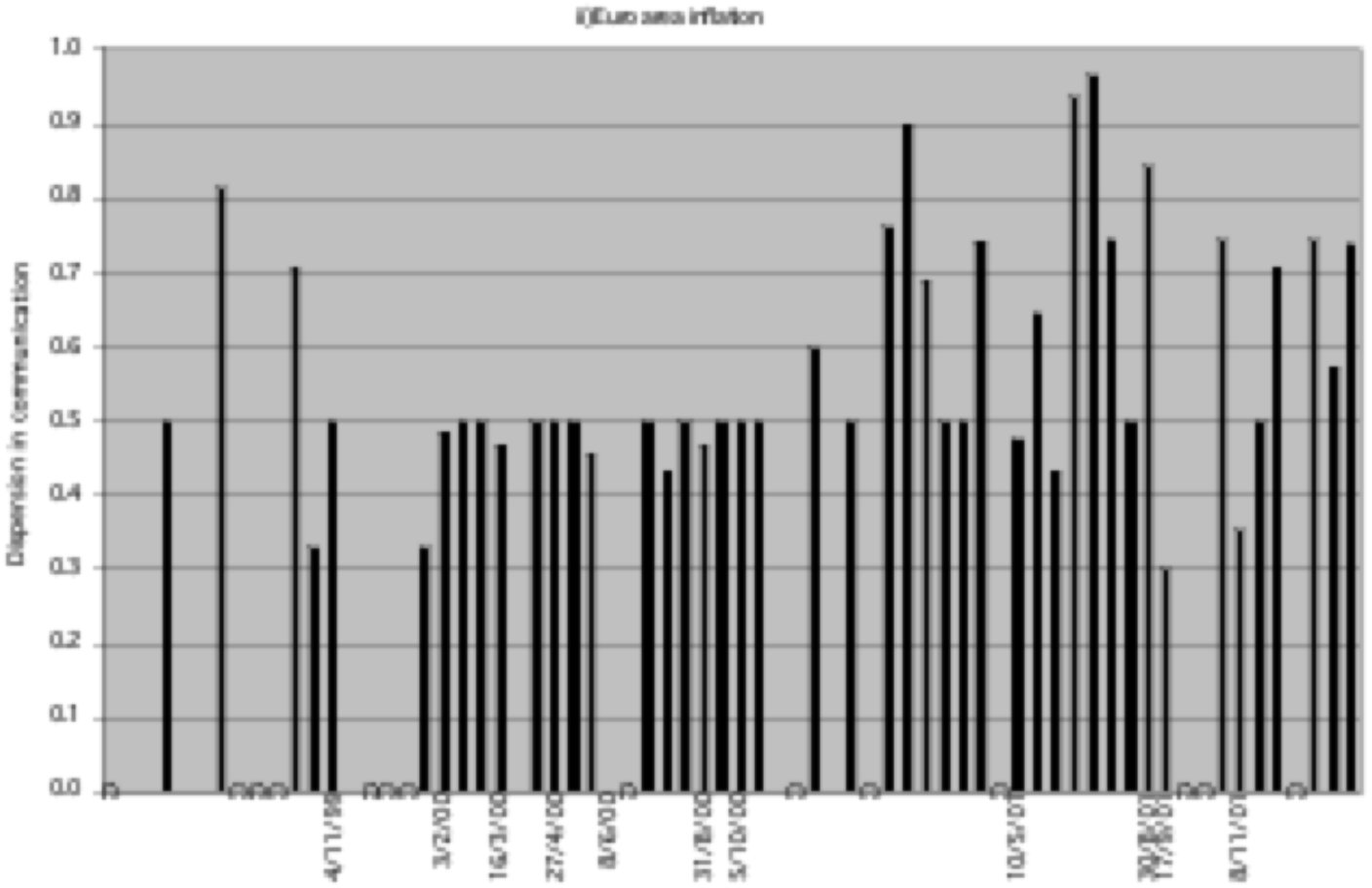
- William Poole (2001) : “The presumption must be that market participants make more efficient decisions . . . when markets can correctly predict central bank actions” (p. 9).
- If communications steer expectations successfully, policy decisions should become more predictable.

Enhancing predictability of policy (2)

- Research has shown convincingly that the predictability of the interest rate decisions of the major central banks has improved remarkably in recent years—so much so that financial markets' expectations nowadays are generally well aligned with actual decisions (Blinder et al., 2008).
- Clearer communication reduces private agents' uncertainty.

What about communication dispersion?

- In earlier work with David-Jan Jansen we focused on ECB statements on the main refinancing rate, the outlook for euro area inflation, and the outlook for euro area economic growth. Per topic, we classified each comment on a ternary scale (-1, 0, +1).
- We measure dispersion in communication by computing the standard deviation of the coded statements.
- The sample period is 6 May 1999 to 2 May 2002.


Euro area inflation
Dispersion in communication
1.0
0.9
0.8
0.7
0.6
0.5
0.4
0.3
0.2
0.1
0.0

Enhancing effectiveness of policy (1)

- Communication may enhance effectiveness of monetary policy by:
  - Affecting long-term interest rates
    (= expected future short-term rates)
  - Affecting inflation expectations
  - Anchoring inflation expectations

Enhancing effectiveness of policy (2)

- Older studies that try to assess the directional intent of the central bank's messages generally find that markets move in the "right" direction—that is, what used to be called "announcement effects" help the central bank rather than hinder it (Blinder et al., 2008).
- This also holds for more recent studies, also if they examine communication about unconventional monetary policy (Blinder et al., 2017)

Trichet even states:

- “under some conditions the central bank can regain control of private expectations without necessarily changing interest rates, but by being visibly and credibly “alert”, explaining and stressing its commitment to maintaining inflation at levels consistent with the price stability objective. The threat to act will be more effective the more credible the central bank has been over time in actually delivering price stability, as defined quantitatively.”

Forward guidance (1)

- Notably now that interest rates are at or near their so-called effective lower bound, many central banks try to affect expectations via forward guidance.
- Effective lower bound (may be less than zero) is result of presence of cash: public prefers to hold cash if they have to pay negative interest on their deposits.
- Forward guidance means that central banks communicate about future stance of monetary policy.

Forward guidance (2)

- Three broad forms of forward guidance:
- (1) qualitative (or open ended) forward guidance: no detailed quantitative information about the envisaged time frame for policy intentions;
- (2) calendar-based (or time contingent) forward guidance, where CB refers to a clearly specified time horizon for its policies; and
- (3) threshold-based (state contingent) forward guidance, where CB links future rates to specific quantitative economic thresholds.

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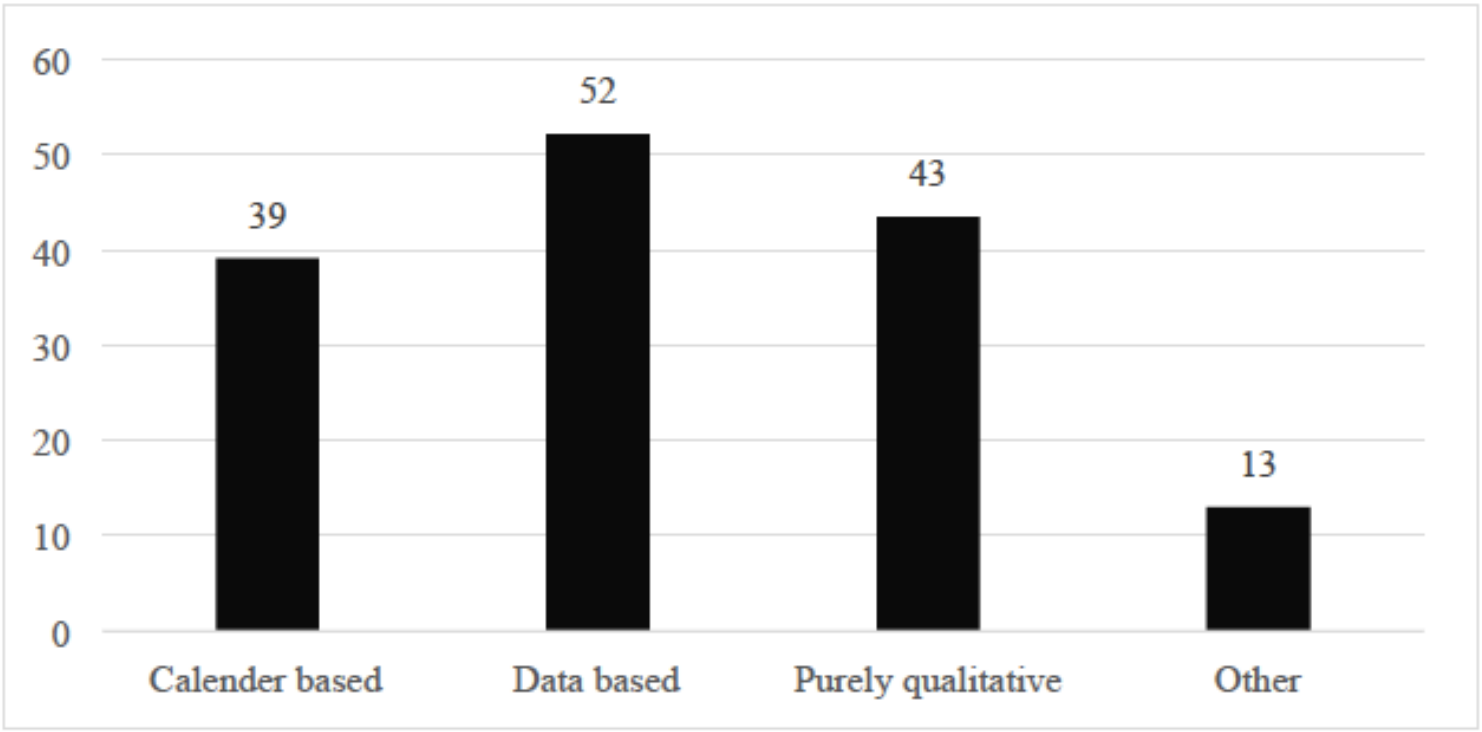


Figure 5. Types of forward guidance used in recent years *(Vertical axis denotes % of responding central bank heads).*

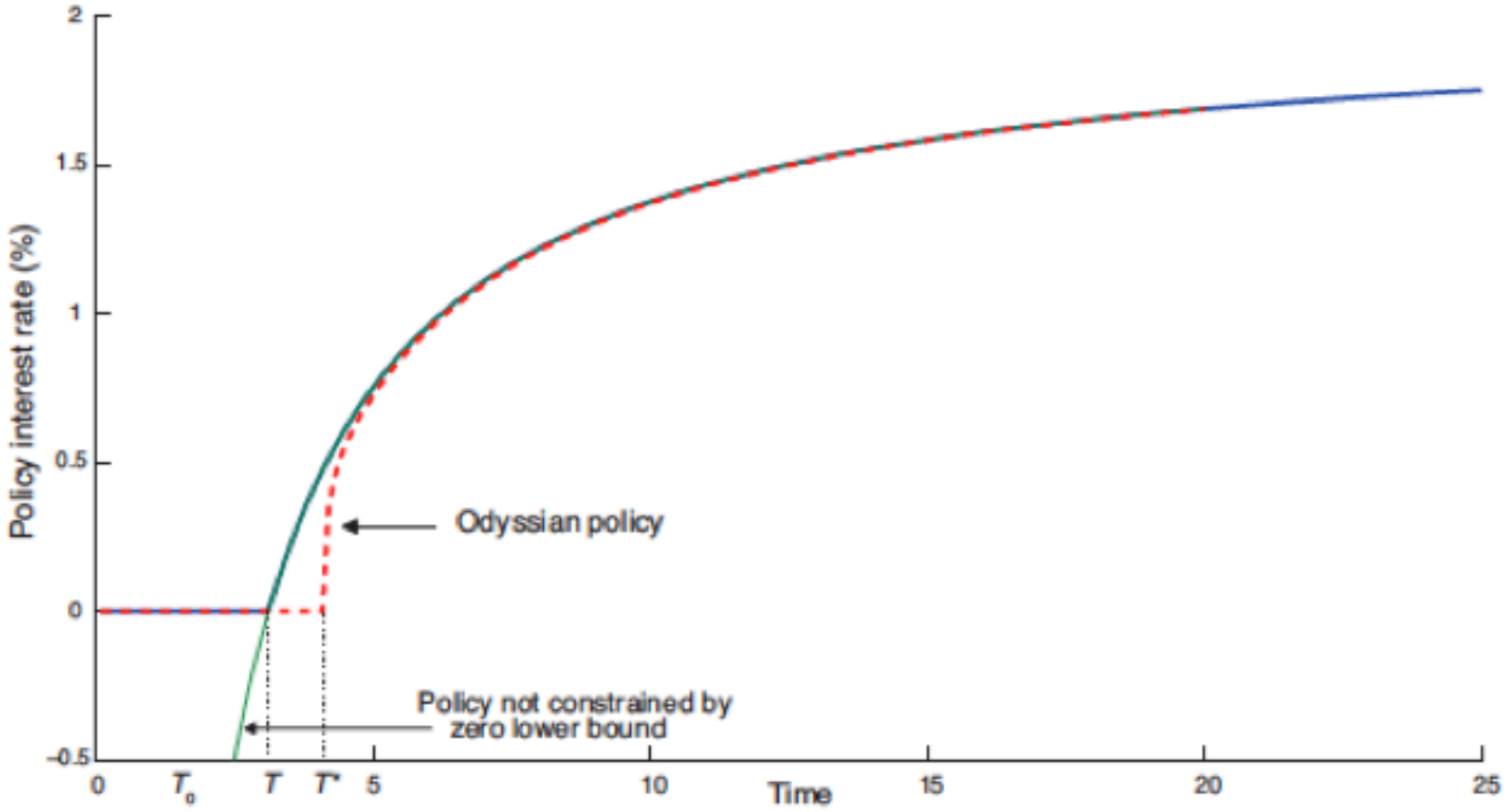
FG may change (1)

- Initially ECB FG was open ended: Monetary policy would be accommodative 'for as long as necessary', while in July 2013 the ECB announced that interest rates would remain at present or lower levels for 'an extended period of time'.
- More recently, the ECB's forward guidance on interest rates has become state (inflation) and time dependent (horizon).

FG may change (2)

- On 14 June 2018, when the Governing Council announced that it would stop QE, it also stated that it expected policy rates to remain at their present levels at least through the summer of 2019 and, in any case, for as long as necessary to ensure the sustained convergence of inflation to levels that are below, but close to 2 per cent (Hartmann and Smets, 2018).

Forward guidance (source: Den Haan, 2013) 2013)



But….

- This is *Odyssean forward guidance* but the main problem with this concept is time inconsistency.
- This contrasts with *Delphic forward guidance*. Under this policy, central banks publish their forecasts of macroeconomic developments and their likely monetary policy actions without any commitment.
- Still, many central bankers believe in “low for longer”.

Example:

John Williams: “The expectation of lower interest rates in the future lowers yields on bonds and thereby fosters more favorable financial conditions overall. This will allow the stimulus to pick up steam, support economic growth over the medium term, and allow inflation to rise.”

FG may go wrong (Moessner et al., 2016)

- BoE announced its (Delphic) forward guidance based on a threshold for unemployment on 7 August 2013.
- However, an unexpectedly strong decline in unemployment forced the BoE already in February 2014 to change its guidance. Despite increased levels of economic activity, the MPC was still worried about the slack in the economy.
- "Within a year, forward guidance had to be dropped, replaced with a far more vague set of promises some nicknamed "fuzzy guidance.""

Table 9. Preferred types of forward guidance in the future

	Governors	Academics	t statistic
Forward guidance in the future (N_{Gov}=51, N_{Acad}=157)			
Calendar based	13.7	10.8	0.6
Data based	27.5	68.8	-5.6***
Purely qualitative	37.3	21.7	2.2**
None	11.8	4.5	1.9*
Other	15.7	3.8	3.0***
Too early to judge	21.6	4.5	3.9***

What impact on inflation expectations? (1)

- Most earlier studies find no or little impact of communication on inflation expectations (Blinder et al., 2008).
- But there is evidence that inflation targeting helps anchoring inflation expectations.
- However, Kumar et al. (2015) find that despite more than 25 years of IT in New Zealand, inflation expectations of entrepreneurs are not well-anchored. Coibion et al. (2018) report that firms devote limited resources to collect inflation information.

What impact on inflation expectations? (2)

- Their experimental evidence suggests that information about the CB's inflation target is quickly tossed aside by managers. So central bankers should expect any changes in expectations to be transitory unless they engage in long-lived communications campaigns. Monetary policymakers' success in achieving low and stable inflation may therefore have inadvertently made their own lives more difficult by inducing managers to turn their attention away from inflation and other aggregate risks.

Communication with public (1)

- Importance of public?
  - democratic legitimacy
  - confidence in monetary authorities
- What does the public know?
- Research with Carin van der Cruijsen and David-Jan Jansen based on survey among Dutch households

Communication with public (2)

- We measure knowledge using a list of eleven statements on the main objective of the ECB's monetary policy:

  The primary objective of the ECB's monetary policy is to maintain price stability. The ECB aims at inflation rates of below, but close to, 2% over the medium term.

- A prerequisite for well-anchored inflation expectations is that the public is aware of the central bank's objective.

Knowledge questions

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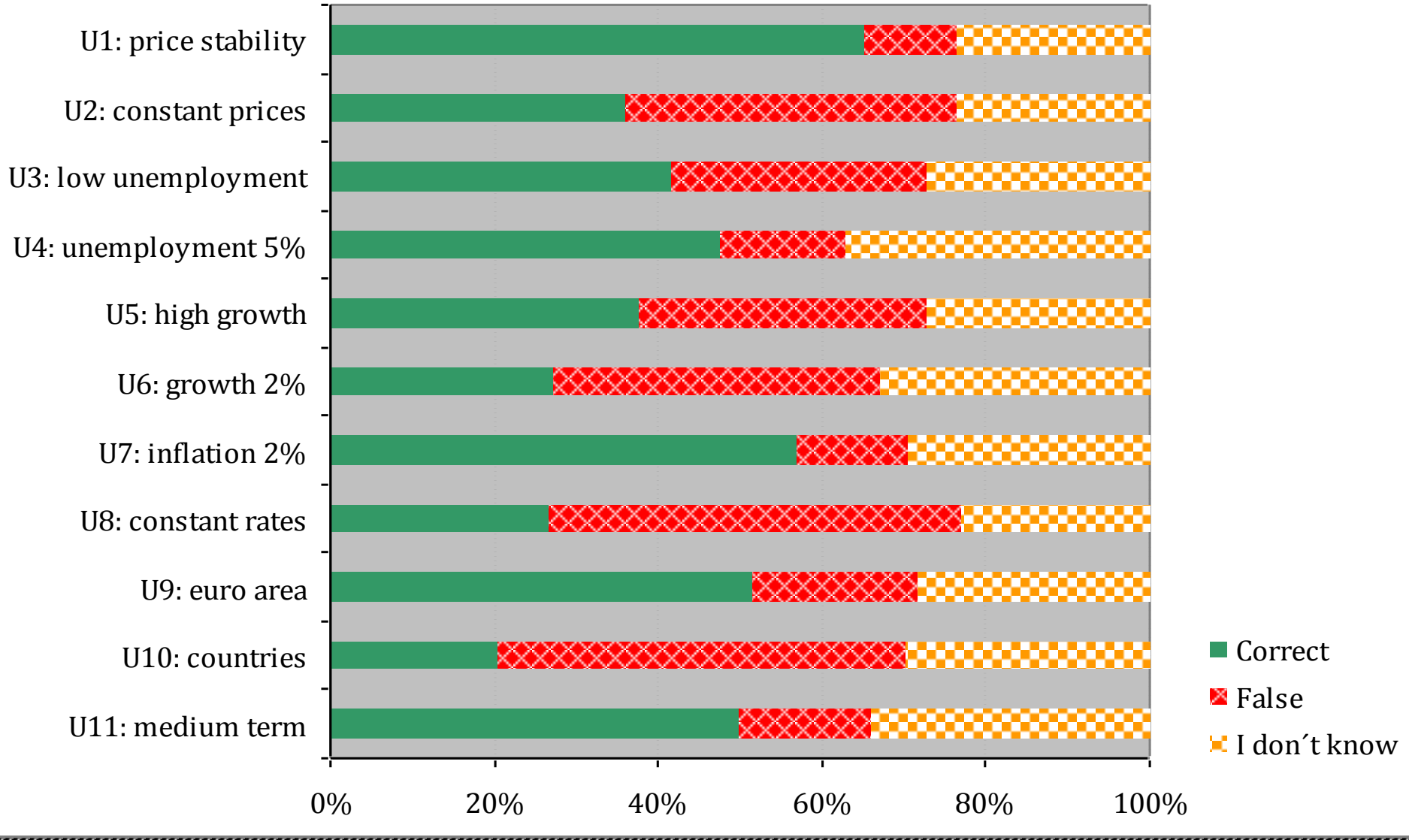
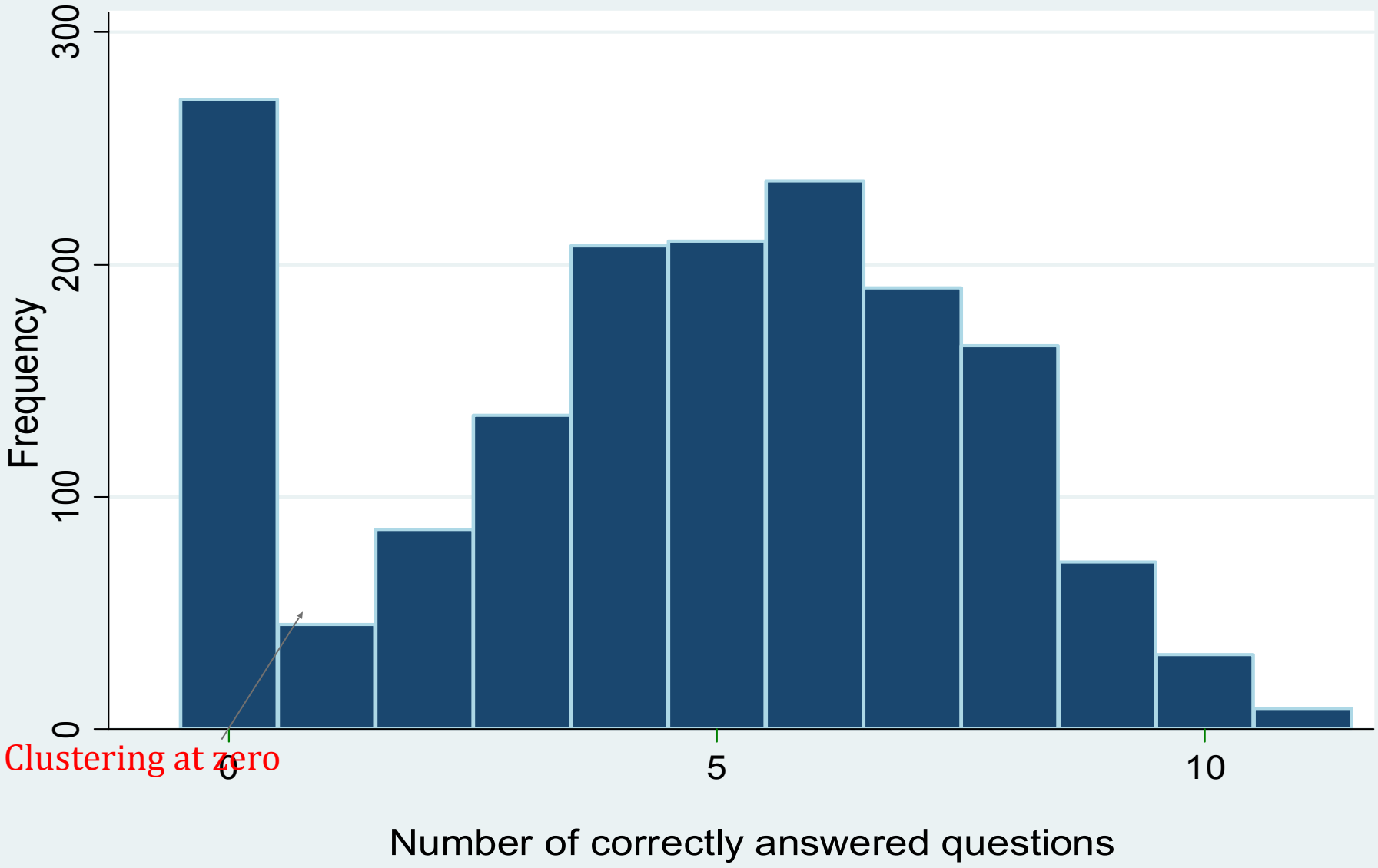
The **main** objective of the ECB…	true	false	I don't know
…is price stability	x		
…is to keep prices constant		x	
…is low unemployment		x	
…is an unemployment rate of at most 5%		x	
…is high economic growth		x	
…is an economic growth rate of at least 2%		x	
…is an inflation rate that is close to but below 2%	x		
…is to keep interest rates constant		x	
…applies to the euro area average	x		
…applies to all euro area countries separately		x	
…applies to the medium-term	x		


U1: price stability
U2: constant prices
U3: low unemployment
U4: unemployment 5%
U5: high growth
U6: growth 2%
U7: inflation 2%
U8: constant rates
U9: euro area
U10: countries
U11: medium term
0%
20%
40%
60%
80%
100%
Correct
False
I don´t know


Frequency
0
100
200
300
0
5
10
Number of correctly answered questions
Clustering at zero

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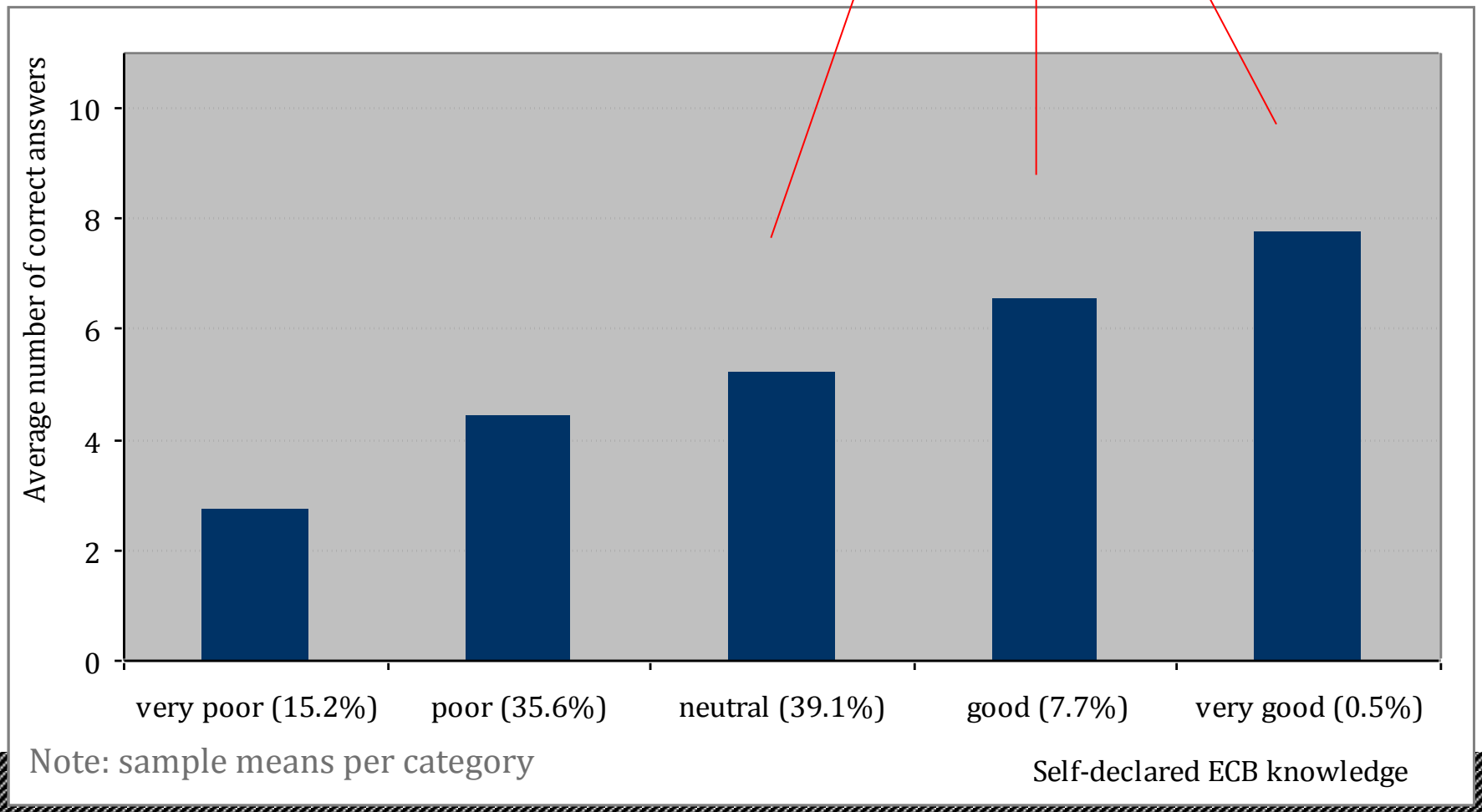
Too optimistic

Self-declared and actual knowledge



Note: sample means per category

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Desire to be informed

Q:

How important is it to you to be well informed on the policies of the ECB?

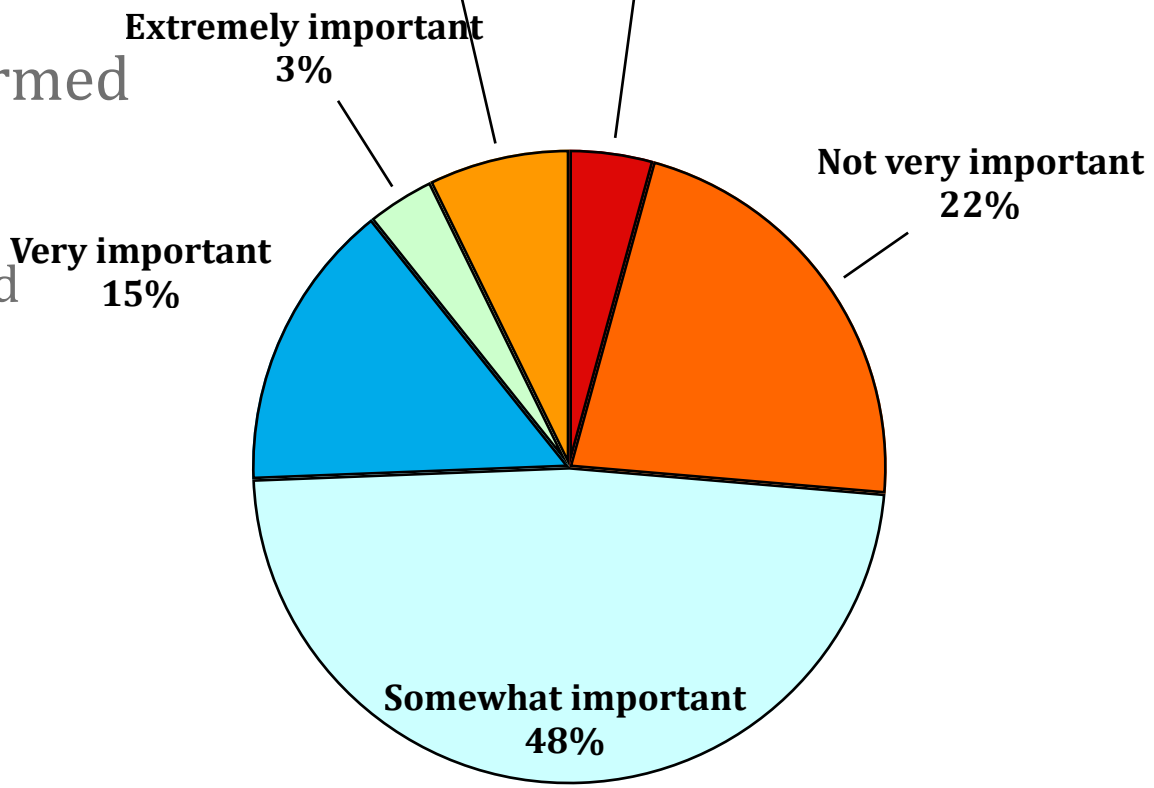

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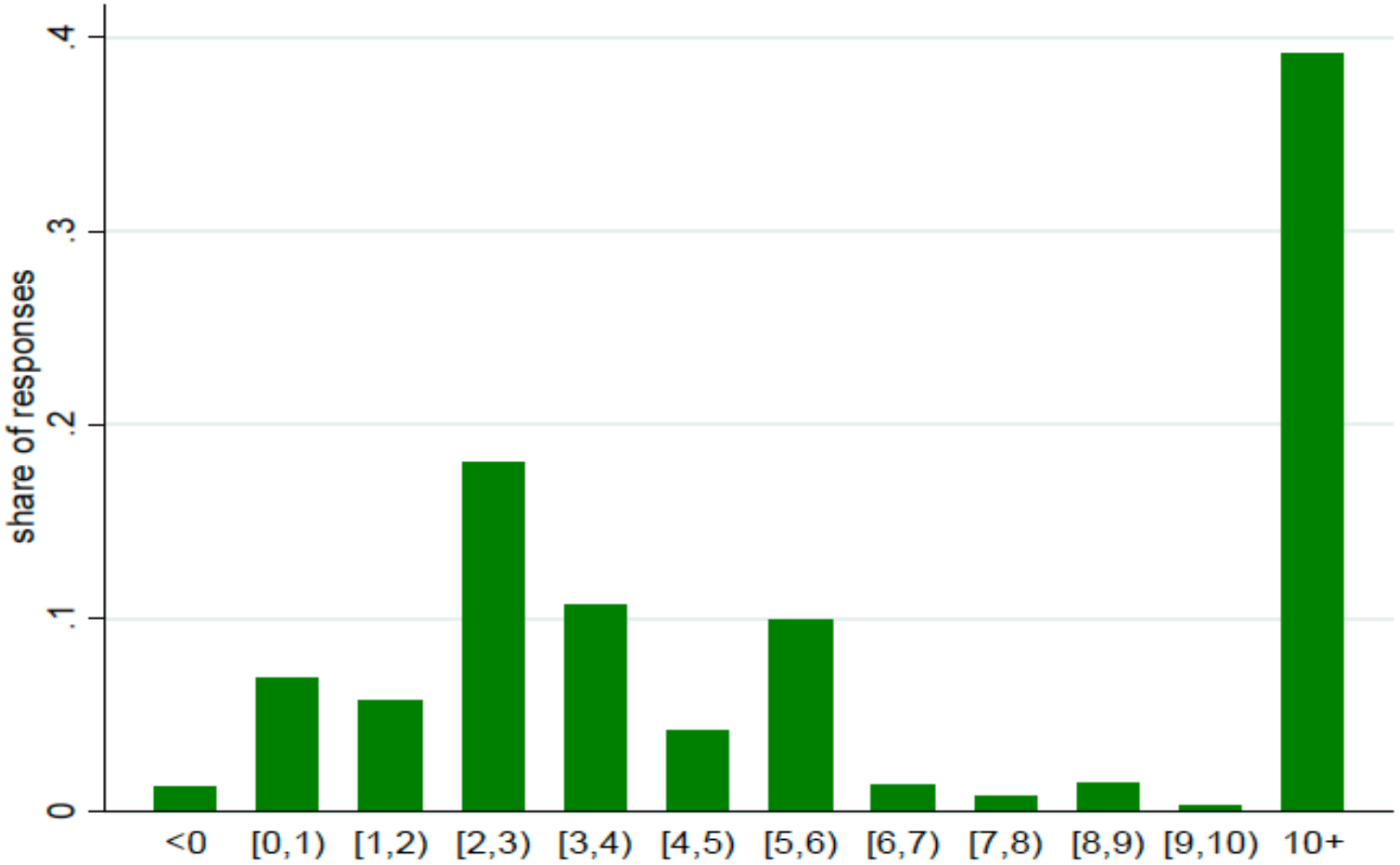
Figure 1: Households' Beliefs about the Federal Reserve's Inflation Target



Communication with public (3)

- So:
  - The public is not well-informed
  - They have a too optimistic view of what they actually know
  - They don't care very much to be informed.
- Challenge is to communicate in a way that reaches public. Bholat et al. (2018) find that recently introduced visualizations in Inflation Report improves comprehension of its message.

Communication: own experience

- DNB used to publish quarterly report which received limited media attention.
- Replaced by DNBulletin: short pieces on our website with policy position, explanation of issues, or about research outcomes.
- Small committee under my chairmanship responsible, but board has to approve.
- Frequency: about 2-4 each month.
- Highly successful in terms of media attention.

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Thank you for your attention