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ECB Statistics Conference: What Did the Financial Crisis Change?

Communicating Central Bank Statistics to the General Public Oct 19 & 20, 2010

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*“The best a central bank can do is to ‘teach’ the markets its way of thinking”
Alan Blinder – The Quiet Revolution – Central Banking Goes Modern, 2004*

The Communication Conundrum

Communication is an important instrument in almost any central bank’s policy toolkit. In the context of the ECB, you could call it the “third pillar” of its monetary policy strategy. The reasons for communicating are obvious: credibility and predictability. In addition, communication allows the central bank to affect market expectations and hence steer the whole yield curve rather than just the overnight rate. Yet, there does not seem to be a consensus yet in the central banking community on what constitutes best communication practises. Empirical evidence suggests that communication is essential to anchoring inflation expectations. But, it seems less clear whether it also anchors actual inflation.

Over time, the predictability of monetary policy decision has improved almost everywhere. However, the puzzle of central bank predictability persists (see *J. Fels, A Tale of Three Central Banks, July 21, 2003*). We find that the most opaque central bank (Federal Reserve) is the most predictable, while the most transparent central bank (BoE) remains the least predictable. The ECB, which has initially been in between, is clearly catching up with the Federal Reserve. But, you still have a one in four chance of beating

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the consensus in the euro area, compared to a one in three change in the case of the UK.

This puzzle applies also to the quantitative information that these three central banks make available to the public. In her paper, Petra Geraats praises the BoE for the extent of quantitative information it publishes both on the baseline forecast and the uncertainty around it, but still it remains the least predictable central bank of the three. Why?

Exhibit 1

How Predictable Are the Central Banks?

	January 1999 – September 2008	US Fed	ECB	Bank of England
Total Rate Changes	45	24	32	
of which				
Expected	42	18	21	
% of total changes	93%	75%	66%	
Unexpected	3	6	11	
% of total changes	7%	25%	34%	

Note: A rate change is classified as expected (unexpected), if a majority of economists surveyed by Reuters ahead of interest rate decisions was forecasting (not forecasting) a change, irrespective of the size of the change.

Source: Bloomberg and Morgan Stanley Research

Communication Strategies

Essentially, there are two communication strategies for a central bank: First, you can regularly outline your current thoughts (*induction*). Second, you can systematically share your thought process (*deduction*). The ECB clearly focussed on the latter from the outset with its two-pillar strategy, its price stability norm – and its strategy review in 2003.

More recently, notably in the last tightening cycle, it has also started to signal its policy intentions using code words in what has become known as the ‘traffic-light system’ (monitoring closely, monitoring very closely, strong vigilance). In the context of this systematic approach to communicating its reaction function statistics play a crucial role. Yet, compared to some other central banks the ECB’s communication on statistics has been relatively sparse. To some extent this is understandable and can partially be

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explained by need to create and/or harmonised euro-area statistics. Next to that the structural break created by the arrival of the euro itself made it more difficult to interpret the available empirical evidence.

Statistics as a Communication Tool

How a central bank utilizes and produces statistics and data should be an integral part of its communication strategy. It is with the empirical evidence that a central bank convinces financial markets, media representatives and the general public that its assessment of the economic outlook is correct. As such providing the empirical evidence is key to a central bank's transparency and, importantly, also its accountability. The financial crisis created massive demand for macro economic information, including data. Economists have never been so busy since EMU started. As the global economy entered uncharted territory, financial markets also needed more guidance. ECB-produced money and credit data became a focus for financial market participants, who fretted about a credit crunch. Money and credit data are also more difficult to interpret (e.g. impact of bad banks).

When financial markets are nervous and trading volumes thin, it is also high season for market rumours. An example would be the "toxic" collateral that the ECB allegedly holds or which banks are exclusively funding themselves at the ECB at the moment. In my view, it is important to debunk popular myths and/or incorrect assertions without getting into a position where the central bank is forced to deny every crazy story out there. Making statistics available will help to nip some "conspiracy theories" into the

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bud. Here, the independence of the ESCB in collecting the data is key to the credibility and integrity of the statistical data. It is vital that markets can trust data on e.g. Greek bank deposits at the current juncture or for that matter the German deposits at the height of the crisis.

Let Markets Work for You

Clearly, communication is not just a one-way street. Especially, when it comes to financial markets, it is important for any central bank not to regard the two-way traffic as a nuisance. While one aim for the central banks is to get its message across, in my mind, it is equally important to use the on-coming traffic emanating from financial markets to your advantage by making conscious use of your intermediaries. Obviously different user groups have different needs, in terms of communication, in terms of statistics.

I will focus on the perspective of a market economist: for us statistics are key. Producing evidence, interpreting evidence is part of our day-to-day job. Here, market economists are multipliers, but they are also sounding boards. Many of us have reasonable quant skills. Our job is to generate information advantages for our clients – internal and external -- using macro economic analysis. Hence, we are always eager to find interesting and importantly new stories in the data. We are a lot less interested in confirming established views. The fact that market economists are always on the lookout for new evidence, new hypothesis that are not yet fully priced into the market can and should be used consciously by central banks. In my view, the competition for the best macro ideas in financial markets is a important counterbalance to the central bank's

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quasi-monopoly position in producing and interpreting statistics in a more hierarchical set-up. Karl Popper taught us that it is important to put one's own working hypothesis constantly to the test as data can only falsify a theory, reject a hypothesis, but never prove it. Hence, the more probing minds the better. More than policy makers, financial markets are interested in turning points (cyclical, secular) and in how the tail risks change. To put it differently: financial markets focus more on the second derivative, less concerned about the second decimal point in the base case scenario. Hence, in addition to being transmission channel for monetary policy, financial markets can complement central banks' in-house analysis via their information processing capabilities.

Statistics in Practice

As statistical information is a public good, it should be disseminated as quickly and as widely as possible. Here an email alert once the data has been made available on the website, which some of the NCBs do already, is very useful. In general, financial markets require fixed release dates and times with no leaks prior to the official release. In addition, big *ex post* revisions in the data are problematic from a financial market point of view. As a picture tells more than a thousand words a fast update of the database itself (esp. to data vendors) is key for our ability to produce meaningful charts.

With respect to the press releases accompanying the data, there is probably less interest in financial markets in a verbal description of the data. Instead, there will be much more focus on any qualifying caveats that help to interpret the data correctly. In this respect, the boxes in the ECB Monthly Bulletin dealing with the interpretation of various statistics

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(e.g. impact of bad bank on lending, M3 in one of the recent editions) provide precious information. For many of its statistics, the ECB also offers great cross-country tables (e.g. MFI balance sheets, would be great to see the same for NCB balance sheets). In Europe, we are still lagging behind in terms of the transparency about the methods behind the statistics (e.g. in estimating GDP).

From a purely practical point of view, it would be great to have the data underlying the charts in the Monthly Bulletin, especially where the data are not available from the Statistical Warehouse (eg. money gap or charts from thematic pieces), in excel format like you can get from the Swedish Riksbank for its Monetary Policy Report for instance.

On my statistical wish list, I also have more timely data on the collateral pledged to the ECB and the use of the ESCB refinancing operation by country (or the NCB balance sheets). Last but not least, I would love to attend launch seminars for any new statistics that are being published and for statistics that the ECB thinks we should use more (e.g. flow of funds).

Do you speak “Statistics”? Lets talk numbers

In their paper Ittner and Schubert ask the question whether central banks should be boring. In my view, they certainly should not aim to be boring with their statistics and their analysis of these statistics. But they do need to reduce the “noise” and, if possible, to increase the “news”.

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What better way to do this than focussing on statistics?

In order to make the statistics even more relevant it might make sense to use visual aids to support the press conference. In my view, it is the same with statistics as with foreign languages: Use it or loose it. After the ECB has successfully managed to communicate in 16 countries in ten different languages in the first decade of its existence, it's might be time to focus a language that should be spoken uniformly across financial markets in and outside the euro area: statistics.