

THE EFFICIENCY OF TRANSPARENT COMMUNICATION OF THE MONETARY POLICY DECISIONS IMPLEMENTED BY THE EUROPEAN CENTRAL BANK

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Abstract:

The main factor in the choice of this research paper was the curiosity of knowing the transparent communication of monetary policy decisions implemented by the most important Central Banks (ECB, BOJ, FED) on economics, in an environment characterized by constant changes in a very short time. Nowadays can be observed an increased interest among people, seen in the most diverse situations, like consumers, investors, producers, for central banks decisions, and the most central banks are more and more focused on transparency, especially in monetary policy, effective communication with the public is considered a priority. A high degree of transparency is an essential element of democratic responsibility of central banks. Transparency also increases the effectiveness of monetary policy to help guide economic agents expectations and bring them in line with political objectives. It is especially important that the markets and the public have a good understanding of systematic and conditional conduct of the central bank monetary policy, so that expectations about future evolutions of prices and rates policy to comply with the mandate of the central bank.

Key words: central banks, monetary policy, the transparency of monetary policy

JEL classification: E52, E58

INTRODUCTION

The main factor in the choice of this research paper, respectively “The efficiency of transparent communication of the monetary policy decisions implemented by The European Central Bank” was the curiosity of knowing the transparent communication of monetary policy decisions implemented by the European Central Bank (ECB) on economics, in an environment characterized by constant changes in a very short time.

The scientific approach involved the efforts of large instruments, combining quantitative research with qualitative research based on the use of methods such as external observation, comparative analysis, processing and analysis of data, documentation of some reports and summary of conclusions.

The study was based on certain methods of scientific research. Research methodology includes defining of the field studied, collecting and interpreting information and strategies of theoretic construction and reconstruction.

In the most part of the work I used the method of comparison to highlight the features of the monetary policy applied by the European Central Bank. Another research method used is the analysis of documents by following the bibliography, conducting comparative studies, analysis of reports issued by various professional organizations, specialist interpretations and materials that have been published in international databases in order to follow the theme, analyzing of the evolution of subject from past to future, from national to international.

Monetary policy is considered to be one of the most important policies, which must be adapted obviously to the economic, political and social context in order to achieve the main objective of state economic policy, namely economic growth.

Transparency can be defined as the measure to which central banks present the information regarding the process of policy making. This information must be clear and opened to public control.

In the last twenty years, central banks transformed and in their transformation process needed to rethink their approaches regarding transparency. Two decades ago, some central banks approaches referred to the spacing and their opacity, central banks were institutions which kept things in secret, they didn't clarify their objectives, instruments and strategies which they applied to the markets.

Mishkin (2004) noted that central banks were mysterious institutions and on the market appeared books with titles like "The Temple Secrets" (Greider, 1987).

Since 1990 we have participated to a revolution regarding the manner in which central banks communicate with the markets and the public.

Nowadays can be observed an increased interest among people, seen in the most diverse situations, like consumers, investors, producers, for central banks decisions, and the most central banks are more and more focused on transparency, especially in monetary policy, effective communication with the public is considered a priority.

This emphasis on transparency and communication has produced many benefits to central banks. By announcing the targets regarding inflation, central banks managed to increase the credibility, to achieve low and stable inflation.

Transparency and communication, especially regarding the achieving of an inflation target announced earlier, helped to build support from the public regarding policies and independence of central banks.

Monetary policy transparency is more common in countries with strong and stable political institutions, in democratic countries.

I. TRANSPARENT COMMUNICATION OF MONETARY POLICY DECISIONS APPLIED BY EUROPEAN CENTRAL BANK

Since the beginning, the ECB needed to carry on simultaneously and rapidly, her role in the economic governance of the European Union and establish the credibility in assuring price stability, being, in the same time, sensitive to the financial markets demands.

ECB defines transparency as "providing openly, explicitly and appropriate, by central bank, all the relevant information, regarding strategies, assessment procedures, procedures and policy decisions in order to inform the public and the markets" (1). This concept is also concerned on the explanations offered by the ECB regarding the interpretations of its mandate and the explicit information of its policy objectives.

Using transparency, the public can understand the monetary policy of BCE, making it more credible and effective.

Transparency can help to increase the efficiency of monetary policy, but may create a conflict for central banks, a highest level of transparency may not be optimal and can lead to less clarity and understanding.

Recognizing the importance of the information access, Geraats (2006) defines transparency of the central bank as "a lack of asymmetric information between the decisions factors of monetary policy and other economic agents", a definition that doesn't mean that the greater is the amount of information published, the greater is the degree of transparency. He believes that a greater transparency should reduce uncertainty and says that "transparency can affect the incentives with which are facing policy makers to manipulate the beliefs of the private sector, by signaling" (2).

Eijffinger and Geraats (2006) have distinguished 5 types of transparency, namely (3): political transparency (refers to the clarity of policy goals), economic transparency (focus on economic information used by monetary policy), procedural transparency (refers to how monetary policy decisions are taken), transparency policy (policy decisions must be informed immediately,

this includes an explanation of the decision and an indication of the future policy actions) and operational transparency (refers to the implementation of central bank policy actions).

Winkler (2002) (4) noted different aspects of transparency used by the European Central Bank, which received more attention, namely: openness, clarity and efficiency of information (Appendix 1), but warns that an effective approach of the communication requires a balance between to be open about the complex character of policy making and to simplify the presentation of this process in the interest of having a better clarity. Other authors believe that monetary policy decisions cannot be made in a completely open manner.

Regular communication about the economic situation is evaluated by a central bank and is very useful and is essential that central banks manifest an open and realistic attitude about what can and what cannot be achieved by the monetary policy. Using transparent ways of accomplish its activities, ECB sustains the idea of credibility.

To ensure transparency, ECB requires self-discipline of monetary policy makers, in this manner is ensuring consistency in time of the explanations and policy decisions adopted.

The former ECB president Jean-Claude Trichet underlined in his speech "successful communication of the central bank accepts predictability and fair price formation in financial markets, contributing to the efficient allocation of funds and reduce uncertainty about future interest rates". Trichet describes a vision of effective communication that requires clarity regarding monetary policy. It recognizes that it is impossible for a central bank (due to uncertainty about economic conditions and changes in the economy, and also the inevitable risks), to report on the market "with an arithmetic precision its future monetary policy decisions".

Making public the monetary policy strategy and communicating the result of regular evaluation of economic evolutions, the ECB facilitates the understanding of the market regarding the systematic model of monetary policy response to shocks and economic evolutions, with predictable monetary policy measures for the markets over a medium term. If markets can predict monetary policy responses, will be allowed a rapid implementation of monetary policy changes in economic variables, which can short the process by which monetary policy is transmitted into investment and consumption decisions.

There are many components at the ECB's strategy regarding transparency and communication, many of them reflecting the practices adopted by other central banks. These can be summarized as follows (5): monetary policy objective and strategy were clearly explained, voting procedures and other aspects of decision making were made public, the ECB holds a press conference in "real time" immediately after Governing Council meetings in which they present the decisions they took and explain the reasons for taking this decision, published its predictions, although it didn't do so at the beginning, but it presents this like the work of staff, the European Parliament is consulted on the appointment of members of the Executive Committee, although it doesn't have a formal veto power, responsibility procedures, such as apparitions in front of the Committee of Economic and Monetary Affairs of the European Parliament, seem to be meticulously observed, and there is also a considerable visibility of ECB before national parliaments.

A high degree of transparency is an essential element of democratic responsibility of central banks. Transparency also increases the effectiveness of monetary policy to help guide economic agents expectations and bring them in line with political objectives. It is especially important that the markets and the public have a good understanding of systematic and conditional conduct of the central bank monetary policy, so that expectations about future evolutions of prices and rates policy to comply with the mandate of the central bank. For all these reasons, the ECB has always tried to be as transparent as possible and tried to communicate clearly, and through a variety of means, political objectives, the strategy, the economic situation evaluations and the perspectives for price stability and the risks associated.

II. COMPARATIVE ANALYSIS OF MONETARY POLICY TRANSPARENCY AND COMMUNICATION APPLIED BY BANK OF JAPAN, EUROPEAN CENTRAL BANK AND FEDERAL RESERVE SYSTEM

Regarding the transparency of ECB, it puts an emphasis on ensuring transparency in decision making process, clarity and effectiveness of information. The minutes published by ECB aren't as transparent as those published by Federal Reserve System (Fed) Bank of Japan (BoJ) because it doesn't want to transmit the impression that it is a place of different national interests. ECB is more collegial in its communication strategy and approach to the decision making process than Fed. This communicates to the public and market participants the decisions that they took in real time, monetary policy decisions taken are communicated monthly at the meetings of the Governing Council.

Collegial approach of communication and decision making, as it is practiced by the ECB will determine monetary policy decisions with a high degree of predictability, and the markets will react similarly to statements to those decisions factors responsible for monetary policy. An approach like that adopted by FED will make predictable monetary policy of the central bank, if markets can discern which statements to watch. Therefore, it is expected that some of the statements of some decisions factors have more influence than others.

Fed emphasis on ensuring transparency in decision making process, increases the efficiency of monetary policy, but may create a potential conflict with central banks: a highest level of transparency may not be optimal and could lead to less clarity and common understanding. Fed officials consider communication a useful tool for building credibility. After each meeting of the FOMC (Federal Committee of free market) are made statements regarding the decisions taken and is published after three weeks from the meeting a report.

Ehrmann and Fratzscher (2005) analyze the communication strategies of Fed and ECB/Eurosystem along three aspects: content, schedule and consistency of communication regarding monetary policy inclination and economic perspectives (6). Regarding the content of the communication, individual FOMC members have a higher degree of dispersion, in what they say, than the members of ECB Governing Council, which suggests that the Fed communication strategy is more individualistic than the ECB one. They analyzed whether these differences in communication strategies have an impact on communication efficiency. They found that the predictability of policy decisions is high for FOMC and the Board of Governors. However, the USA market reaction regarding the statements of the President are significantly stronger than the statements made by other members of the FOMC, it differs from the euro-zone, where markets respond similarly to the communication of the ECB president and other members of Governing Council. The two authors concluded that policies of both the ECB and the Fed are equally effective, despite of the fact that they follow different strategies of communication.

The minutes published by BoJ are more transparent than those of the ECB. BoJ representatives consider that the effects of monetary policy will enter easily if market participants gain a better understanding of the bank thinking. The law requires the bank to clarify in public its decision content and also the decision making process. BoJ released the minutes of MPMs (monetary policy meetings) at one month after each meeting. After the meetings of the Policy Council is published a monthly report. The Governor of the Bank organizes regular press conferences to explain monetary policy decisions that were taken.

III. TRANSPARENT COMMUNICATION OF MONETARY POLICY APPLIED BY THE NATIONAL BANK OF ROMANIA

The transparency of monetary policy applied by the National Bank of Romania (BNR) assumes: public announcement of inflation targets, accessibility of information to permit the evaluation of monetary policy orientation, announcing and explaining monetary policy decisions and a detailed ex- post analysis of monetary policy performance.

Characterized by a high transparency, monetary policy implemented by the central bank aims to establish a determined interval of inflation level, to which monetary authority aims to achieve. So the public can know in advance which the central bank directions of action are.

BNR presents annually to the Parliament the monetary policy applied in the last year and guidelines for the present year, responding to him for achieving the proposed objectives. Through the monthly bulletins, through its annual report and her press conference, BNR explains to the public the evolutions from the real economy and financial markets, monetary and exchange rate policy decisions taken and the reasons why it could not achieve the inflation target. Regarding monetary policy orientation, the information presented is limited to the actions taken by the central bank in the analyzed period, missing the adequate technical machine which permits to develop an anticipate vision. Retrospective analyzes are necessary but aren't sufficient for the adoption of direct inflation targeting regime, it is essential to be a practical attitude of central bank. This information should not miss in case of the adoption of direct inflation targeting regime, generally was made public through an "Inflation Report" - the main mode of communication of the central bank, from which it assumes responsibility for the achieving the proposed objective.

The central bank communication with the public and financial markets have improved considerably in the last years, through greater availability for dialogue of the management of BNR (through meetings with banks, interviews, organizing seminars) and also between the transparency ensured by moving of the emphasis from direct instruments of monetary policy to indirect instruments.

The BNR Governor, Mugur Isărescu, admitted that it is extremely important how the central bank informs, he said that "All the seminars which we organize at BNR aren't a fad. Obviously, there are monetary policy instruments - minimum reserves required, interest rate, intervention on monetary and foreign exchange market - but the transmission is done through messages. (...) Communication is essential for a central bank" (7).

Central bank's disinflation efforts may have desired realization only if the public trusts in the strategy applied and adjust their inflation expectations according to the announced objective. So far, this hasn't happened only partially, the credibility of the authorities being eroded by the fact that the original target of inflation has often been adjusted ascending within the relevant time horizon target.

IV. THE EFFECTS OF MONETARY POLICY TRANSPARENCY

Some previous studies suggest that more transparency should be associated with a reduction in uncertainty about future policy actions and with a reduction in inflation volatility. Demertzis and Hughes Hallett (2003) found a negative relationship between inflation variability and central bank transparency (8). Other studies suggest that there is less variability and dispersion in inflation expectations when central banks publish numerical targets for inflation. Other authors suggest that more transparency should be associated to persistent inflation, provided that monetary policy credibility is increased and market participants don't extrapolate future inflation to current inflation.

Blinder (2006) believes that the most important attributes of transparency and communication are: clarity, content and openness to public control, especially regarding the manner of decisions making.

There is a large consensus on the fact that besides the role of the responsibility of central bank, transparency can help to increase the efficiency of monetary policy. However, the central bank is facing with a potential conflict, considering that a minimum level of transparency is not necessarily an optimal one for efficiency in following the objectives set out in the mandate. Such a conflict can occur when extra information doesn't help to clarify the situation on the market, because there are limits regarding the amount of information that can be processed effectively. Furthermore, too much information can prevent the formation of individual opinions that are a source of information extremely important for a central bank and, consequently, for the efficiency of monetary policy.

Transparency, therefore, is not a purpose, it is just a way to help the central bank to achieve the objectives settled out by mandate. The tendency for decisions to be made by the Committees makes to become more relevant the individual communication with individual members of the committee.

Other authors argue that it may be desirable to communicate various viewpoints available in the committee, otherwise they would lose much of its clarity. Communication strategy of the central bank is not independent in the process of decision of the committee. Decisions can be taken in a collegial manner, or individualistic, encouraging the members of the Committee to vote according to personal opinion. In its turn, efficiency in communication and, therefore, the choice of communication strategies largely depend on the nature of decision-making process.

The effects of monetary policy transparency are focused on three results, namely, predictability (transparency improves predictability of monetary policy actions and results), reputation (transparency aims to induce increasing reputation because is increasing the sensitivity of confidence in private sector in unpredictable political action and results) and credibility (transparency has the potential to increase the credibility and make more stable in the long term the inflationist expectations of the private sector).

Measuring transparency can be achieved by observing the reactions of financial markets and revealing the relevant information in the preparation of monetary policy.

Transparency increases the efficiency of monetary policy. Transparency about monetary policy objectives, expectations and strategies is necessary for an efficient communication with the markets. Transparency policy facilitates for observers the anticipation of central bank actions and minimizes the disturbances when policies are changing.

CONCLUSION

Transparency has become a vital part of central banks and central banks around the world have chosen to adopt a more open approach of providing information to the markets on the one hand, and submission it to a control on the other hand.

A higher transparency of central bank operations is the recent change in the course of monetary policy. We understand this as a response to the changes in the monetary policy environment.

Transparency is a virtue, but like all the virtues it can go too far. Central banks may be too transparent.

Central banks transparency should always be considered as a way to achieve a goal. This is beneficial when is used to simplify communication with the public and helps to support the central bank to achieve an optimal monetary policy, with a focus on the long term goals.

Regarding the institutional and macroeconomic environment, transparency is in large part unrelated to central bank independence, but is positively related to the initial inflation and economic growth, and negatively related to future inflations.

Although transparency tends to be used more frequently in inflation targeting by adopting inflation targeting, there is not guaranteed transparency in all the aspects. Furthermore, there is a remarkable variation in the degree of disclosure of information in the inflation targeting and in other parts of applying of monetary policy.

The ECB has always tried to be as transparent as possible and tried to communicate clearly, and through a variety of means, political objectives, the strategy, the economic situation evaluation and the perspectives for price stability and associated risks.

Transparency of monetary policy could lead to a higher predictability of policy actions and reduce inflation. However, there remain many challenges in terms of communication and central banks are susceptible to continue their efforts to achieve a higher transparency of monetary policy in practice.

Financial globalization and political democratization are leading to a higher transparency in the course of monetary policy.

Information relating to monetary policy decisions of central banks communicated transparent to the public can help in making various analyzes or application of econometric models to predict certain situations (e.g. establish a link between euro exchange rate, inflation and monetary policy rate using a multiple linear regression model).

The information communicated in a transparent manner by the central bank [can be used to estimate trends in the demand of money (liquidity), interest rate, investment, savings, exchange rates and others.

For a better understanding of how to use data relating to monetary policy communicated transparent by the central bank we can realise a future study where we can apply an econometric model of multiple linear regression, using data provided by the central bank.

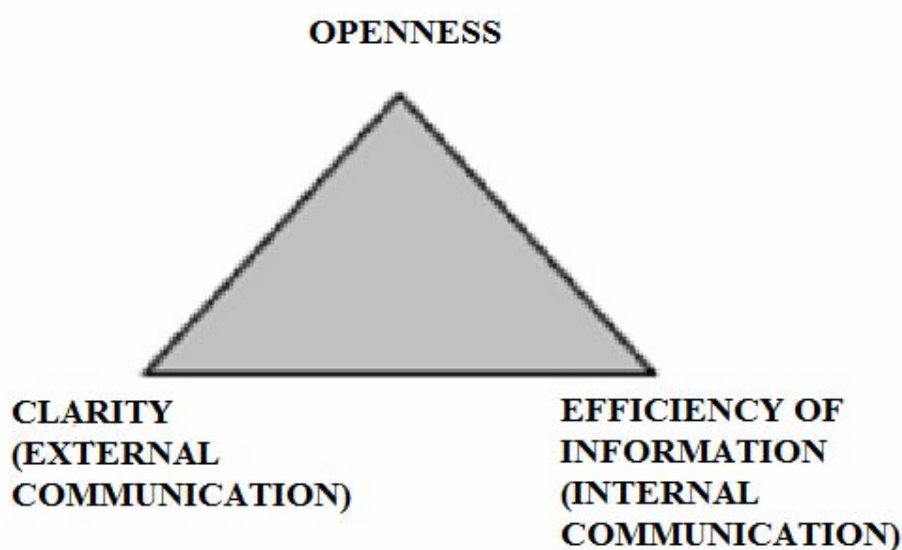
We can analyze the link between the euro exchange rate and the inflation rate, followed by analysis of the link between the exchange rate and interest rate and finally the relationship between all three indicators: the exchange rate, inflation rate and interest rate in Romania. We will choose as a dependent variable the euro exchange rate and as independent variables inflation and interest rates. We can use annual data for Romania from the period 2005-2013, the data series will be taken from the website of the National Bank of Romania. Data can be processed using SPSS program.

Regarding the evolution of monetary policy in the future some analysts believe that IT developments will have an impact on monetary policy, reducing the power of monetary policy and financial independence of the central bank, but the impact of central banks on interest rates will not stop completely because the electronic money generates more risks than the central bank money and there are doubts about using it successfully.

Others argue that with IT advances is necessary to consider whether or not monetary policy is effective because electronic money, compared with central currency has some advantages (low costs), which will lead to an increasing demand for electronic money, reducing the future involvement of central banks.

Central banks maintained over time, in dealing with changes in the economy, continually renewing, which means that they will find ways to meet the challenges that will face monetary policy and continued to ensure the worldwide financial system stability, as it did in the past.

Appendix 1. Aspects of Central Bank transparency



Source: D. Gerdesmeier, F.P. Mogelli, B. Roffia, Eurosistemul, Rezervele Federale ale SUA și Banca Japoniei, nr. 742, martie 2007, p. 19.

ENDNOTES:

- (1) <http://www.ecb.int/ecb/orga/transparency/html/index.ro.html>, accessed at 10.02.2013;
- (2) I. Begg, *Economic policy and institutional transparency: the ECB*, European Institute, London School of Economics and Political Science, p. 3;
- (3) D. Gerdesmeier, F.P. Mogelli, B. Roffia, *Eurosistemul, Rezervele Federale ale SUA și Banca Japoniei*, nr. 742, martie 2007, p. 18;
- (4) Author quoted in D. Gerdesmeier, F.P. Mogelli, B. Roffia (2007), *Eurosistemul, Rezervele Federale ale SUA și Banca Japoniei*, nr. 742, pp.18-19;
- (5) I. Begg, *Economic policy and institutional transparency: the ECB*, European Institute, London School of Economics and Political Science, p. 7;
- (6) D. Gerdesmeier, F.P. Mogelli, B. Roffia, *Eurosistemul, Rezervele Federale ale SUA și Banca Japoniei*, nr. 742, martie 2007, p. 20;
- (7) <http://m.hotnews.ro/stire/10337509>, accessed at 20.02.2013;
- (8) N. Dincer, B. Eichengreen, *Central Bank Transparency: Causes, Consequences and Updates*, 2009, p. 19.

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13. <http://m.hotnews.ro/stire/10337509>;
14. <http://www.bnr.ro/Home.aspx>;
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