

Michael Ehrmann

Head of the Monetary Policy
Research Division

European Central Bank



Dimitris Georganakos

Lead Economist in the Monetary
Policy Research Division

European Central Bank



Geoff Kenny

Head of the Monetary Economics
Section

European Central Bank



ECB can gain credibility by explaining its monetary policy strategy to the public¹

With the rapid increase in euro area inflation, it is ever more important that the European Central Bank (ECB) maintains its credibility, also among the wider public. Although it is hard to reach out to this group, our recent research (Ehrmann, Georgarakos and Kenny, 2022) shows that explaining and communicating key elements of the ECB's new monetary policy strategy can enhance the perceived credibility that price stability will be maintained. In particular, randomized information treatments in the new Consumer Expectations Survey reveal that effective communication about the symmetric inflation target can raise credibility among survey respondents, especially if the stabilizing role of monetary policy is also explained. However, the communication of a decision to take better account of climate considerations and a promise to better capture housing costs in inflation measures yield neither marginal credibility gains nor losses.

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Introduction

Central banks have traditionally focused their communication on expert audiences, and in particular on financial markets. Communication with non-experts, in contrast, has long been considered to be less relevant. Only recently has this changed: Following the global financial crisis and the extensive deployment of unconventional monetary policy tools, central banks and their policies became the subject of an often-controversial debate that saw the involvement of larger parts of the general public (Blinder et al., 2017). Against this background, many central banks have strengthened their efforts to communicate with the general public. As described in Assenmacher et al. (2021), the European Central Bank (ECB) has also recently evaluated its communication policies in the context of its strategy review. As part of the outcome of this strategic review, the ECB has decided to improve communication with the wider public, including the regular conduct of outreach events to help ensure “public understanding of and trust in the actions of the ECB” (ECB, 2021a).

Arguably, communicating with the general public has become even more important for the ECB given the current inflationary environment. Inflation in the euro area has increased sharply over the course of 2022 and it is now well above the ECB's target of 2%. Some people are even warning that we might see a repeat of the persistent inflation experience of the 1970s. To avoid such a scenario, inflation expectations need to remain well anchored. Indeed, several factors suggest that inflation expectations are more firmly anchored today than in the 1970s – not only in the euro area, but in advanced economies more generally. For example, central banks nowadays have a much better track record as inflation fighters, and they have made substantial efforts to communicate their inflation targets and strategies.

Experts, of course, are well aware of these efforts. But what about the wider public? The general public has less background knowledge in economics and often is not informed about the central bank's target or its monetary policy strategy. Would efforts to communicate more effectively with the general

¹ The views expressed herein are the authors' personal opinions and do not necessarily reflect the views of the ECB or the Eurosystem.

public help anchor inflation expectations and ensure that central banks maintain high levels of credibility in their commitment to maintain price stability? In a recent study (Ehrmann, Georganakos and Kenny, 2022), we highlight the challenge posed to central banks in reaching non-experts. Yet we also identify the significant potential credibility gains that might be achieved if central banks are able to channel critical information about their monetary policy to consumers.

Challenges and potential gains for central banks in reaching non-experts

On July 9, 2022, the ECB announced a change in its inflation target and its monetary policy strategy following an extensive internal review (see ECB, 2021a). However, in our recent study, we find that the outcome of the strategy review seems to have gone largely unnoticed by consumers. Using the ECB's Consumer Expectations Survey (CES), we asked consumers in September 2021 whether they had heard about the ECB in the course of the summer.² The majority of respondents made clear that they had not. Also, among those who did hear something about the ECB, most did not recall what they had heard. Only about 10% of consumers answered that they had heard about a new strategy.

That the ECB's communication largely went unnoticed following a major strategy review announcement is sobering and points to the need to reassess both the channels and nature of communication with the public. What if the ECB had been able to more effectively communicate the outcome of its new strategy to the public? What might be the potential benefits of a public that is more informed about monetary policy?

To get at the answers to these questions, again using the CES, respondents were given different "information treatments", an approach also used in medical trials. One random group, the "control group", did not receive any specific information "treatment" (similarly to the group that receives a placebo treatment in a clinical trial). Four other treatment groups received certain different pieces of information. Specifically, a first treatment group was informed that the ECB aims for a 2% inflation target that is symmetric, meaning that inflation may sometimes be slightly above it or below. The precise information provided was the following: "The ECB aims for a 2% inflation target over the medium term as the best way to maintain price stability. The target is symmetric: inflation may sometimes be slightly above it or below. The ECB looks through short-term deviations. Persistent negative and positive deviations are regarded as equally undesirable."

A second treatment group was given the above information, but was also provided with more information on the economic background, explaining how an inflation target helps in stabilizing the economy and contributing to economic growth and employment. In particular, this group was given the following additional explanation about the functioning of the inflation target: "A target of 2% has an important function: it creates space so that monetary policy can have its stabilising effect. In bad times, such as during the pandemic, monetary policy stimulates the economy through low interest rates and so has significant favourable effects on economic growth and employment. This may also imply a transitory period in which inflation is moderately above the target of 2%."

² ECB (2021b) and Georganakos and Kenny (2021) provide a detailed overview of the CES dataset.

Two more groups also received the basic information about the inflation target and were in addition told about two concepts in the new strategy that consumers might particularly relate to. One of these treatments referred to the role of climate change in the new strategy, pointing to its importance for the ECB's mandate and the need for the ECB "to account explicitly for the implications of climate change and the carbon transition." Lastly, a fourth treatment group was provided with information about the ECB's plan to better capture housing costs in inflation measurement. This information treatment represents a promise by the ECB to "work towards" a better coverage of housing costs and thus left somewhat open the eventual outcome or its timing. These information treatments are described in more detail in Ehrmann, Georgarakos and Kenny (2022).

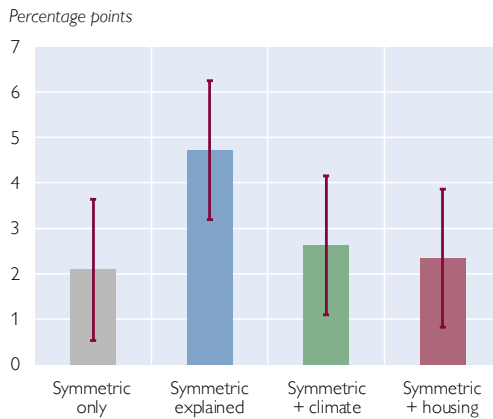
Evidence of credibility gains among non-experts

To measure the effects of the above information treatment on credibility we asked all groups the following question: "How likely do you think it is that the ECB will maintain price stability in the euro area economy over the next 3 years?" The replies can then be compared across the control and treatment groups, thus providing a clear measure of how communicating the key outcomes of the strategy review impacts on the perceived ECB credibility or likelihood of price stability being maintained.

The outcome of our information experiment demonstrates that successful communication with the general public can enhance the ECB's credibility. Chart 1 shows the immediate effect of the treatments in September 2021. All estimated effects represent changes compared to the control group that has not received any information. The chart

Chart 1

Effects on the likelihood that the ECB delivers price stability relative to control group



Source: ECB Consumer Expectations Survey (CES) – September 2021.

Note: Regression estimates and 95% confidence intervals per treatment group.

shows that credibility is enhanced for all four treatment groups, and much more so for the second group that received the information about the symmetric inflation target plus the additional background explanation about the functioning of the target and the stabilizing role of monetary policy. For this group, the probability that the ECB will achieve price stability over the next three years increases considerably, by 4.5 percentage points. For the two other information treatments about the role of climate change and envisaged improvements related to the measurement of housing costs, the effects are almost identical to receiving only the information about the symmetric target on its own. Hence, the communication of these decisions did not appear to either enhance or diminish the credibility that price stability would be achieved over the coming three-year period.

Chart 2 shows the same results but splitting the CES sample into consumers with relatively high (above median) and relatively low (below median) levels of financial literacy. The financial literacy

indicator follows measures described in Lusardi and Mitchell (2014) based on the number of correct answers to a set of four standardized questions about financial concepts that respondents are asked in the background questionnaire when joining the CES panel. The results in chart 2 show that most of the credibility improvements are driven by consumers who are more financially literate, highlighting the additional challenge central banks face in reaching out to consumers with relatively lower levels of financial literacy. However, credibility among consumers with low levels of financial literacy is gained only if they receive the background explanation provided to the second treatment group. Providing people with some background explanation thus appears to be very important to generate positive effects on credibility.

Interestingly, we also repeated the above analysis in subsequent survey rounds, including in March 2022, a period when inflation had already started to accelerate significantly in the euro area. By then, the effect of the information treatment had effectively disappeared for most groups, highlighting

how central banks need to maintain persistent and open lines of communication with the public to ensure their messages are not lost. However, an exception is the second treatment group, which had benefited from getting a more complete explanation. This illustrates how important it is to give such broader explanations about monetary policy when communicating with the public.

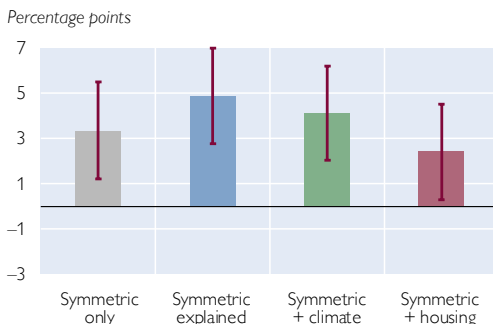
Conclusions

Our results offer significant endorsement of the potential benefits to central banks from efforts to enhance their communications with non-experts. By working to raise awareness about the inflation target and its relevance in the current economic context, such efforts can yield a clear payoff by contributing to raising the public’s perception that price stability will be maintained in the future. Of course, for such a payoff to be achieved, the ECB will need to identify the most effective communication channels that can support this endeavor. In addition, it will face important – but not insurmountable – challenges particularly when it comes to its communication with less financially literate consumers.

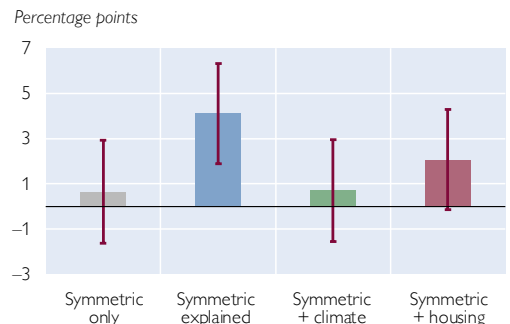
Chart 2

Effects on the likelihood that the ECB delivers price stability relative to control group

(A) High financial literacy



(B) Low financial literacy



Source: ECB Consumer Expectations Survey (CES) – September 2021.

Note: Regression estimates and 95% confidence intervals per treatment group.

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