

# Central Bank Communication and the Financial Markets

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Discussion by

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The usual disclaimers apply.

# What the paper does

- **Provides an excellent survey of the current practice of central bank communication and a review of the empirical evidence**
- **Proposes greater transparency (conditional on high quality)**

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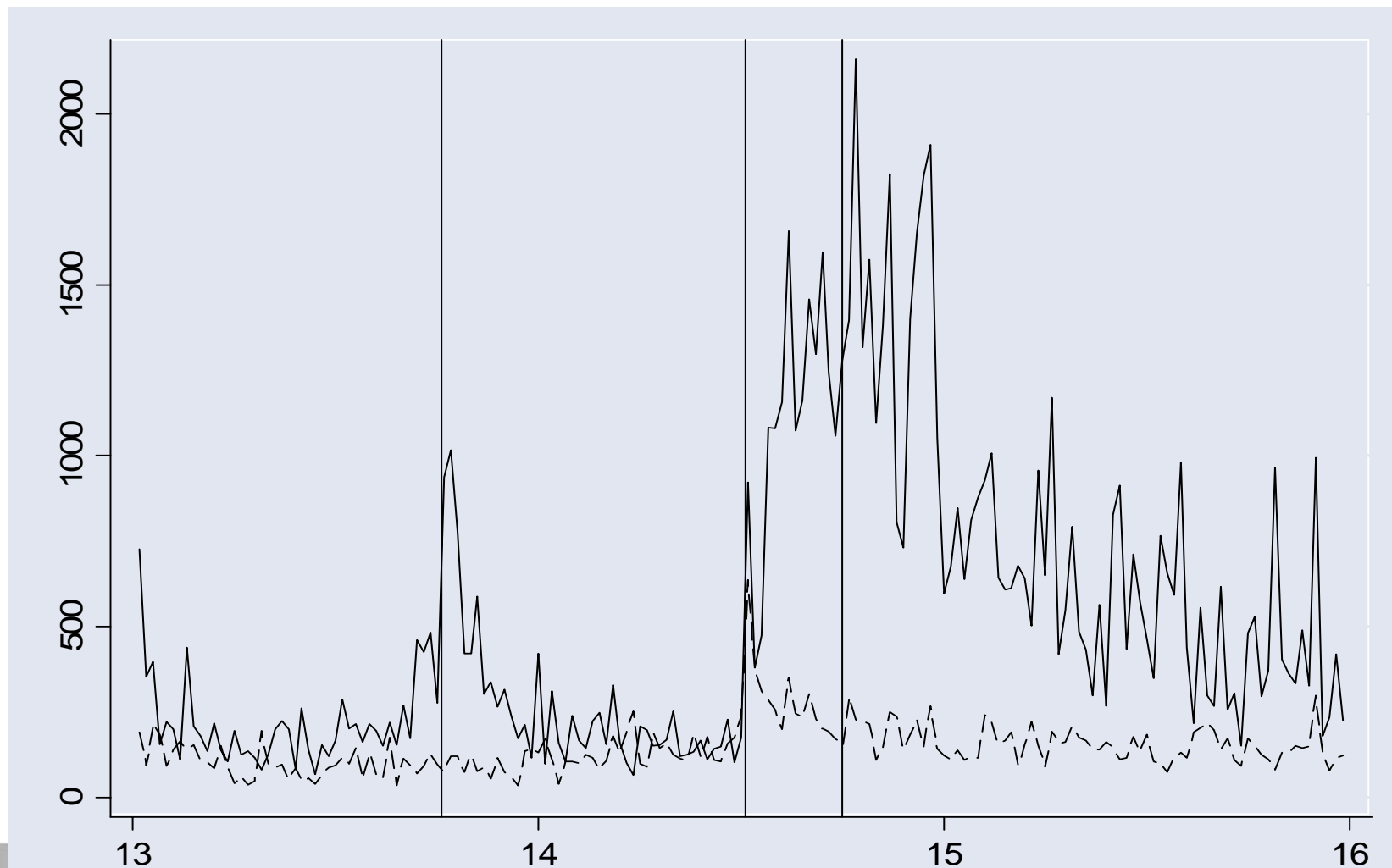
- **Provides an excellent survey of the current practice of central bank communication and a review of the empirical evidence**
- **Proposes greater transparency (conditional on high quality)**
- **Reflects Alan's unique exposure to the topic**
  - **Recipient**
  - **Sender**
  - **Shaper**
  - **Student**
  - **“One of my all-time favorite subjects”**

# Outline of my discussion

- **How to add value?**
  - **Complementary thoughts rather than critical remarks**
- **The role of press conferences**
- **Limits to communication: blackout periods**
- **What about the recipients' side?**
- **Communication with other target groups**

# The role of press conferences

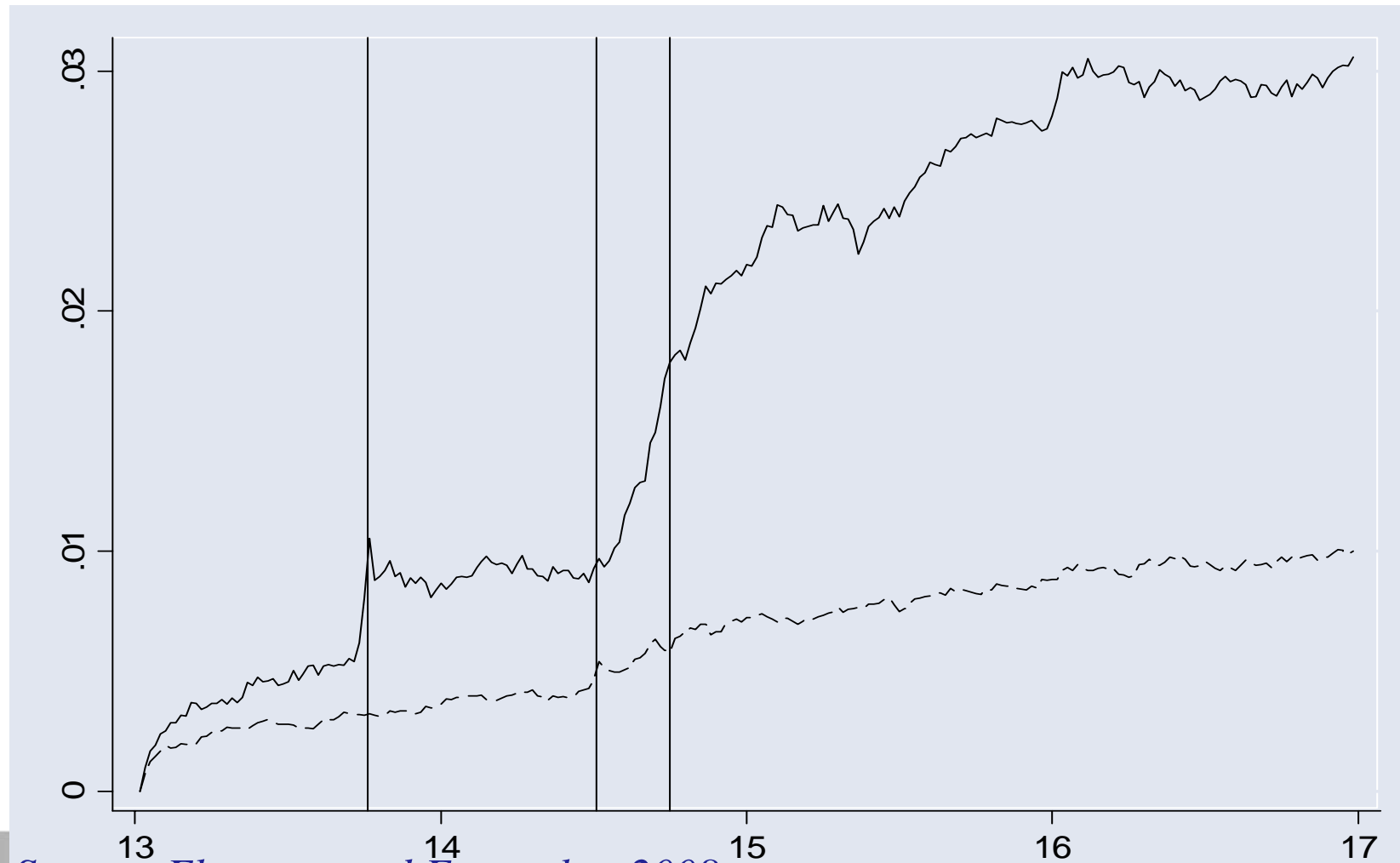
- **Average volume in 3-month Euribor futures, 13:00-16:00**
  - **Press conference days (solid) vs. other Thursdays (dashed)**
  - **Number of contracts (over € 1 million each) traded per minute**



Source: Ehrmann and Fratzscher 2008

# The role of press conferences

- **Price movements in 3-month Euribor futures, 13:00-16:00**
  - **Press conference days (solid) vs. other Thursdays (dashed)**
  - **In absolute terms, relative to levels at 13:00**



Source: Ehrmann and Fratzscher 2008

# The role of press conferences

- **Central banks need to get the attention of their addressees**
- **Coverage in newswires crucial for that purpose**
- **Beechey and Wright (2007): Markets react to rounded number in macro news releases**
  - **These appear on first page and get covered by newswires**
  - **More precise number in the text of the release gets systematically ignored**
  - **Important, e.g., for US CPI, where rounding is relatively large**

# The role of press conferences

- **Press conferences get more coverage in newswire reports**
  - **Coverage of Bank of England minutes, November 17, 2004 (20 pages of text): 8 snaps, all sent at the same time**

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Time	Snap
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10:30	BOE MINUTES-MPC VOTED 9-0 FOR KEEPING RATES STEADY AT 4.75 PCT IN NOV
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10:30	BOE MINUTES SHOW MPC DID NOT DISCUSS RAISING RATES AT NOV MEETING
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10:30	BOE-Q3 GROWTH WEAKER THAN EXPECTED, HOUSE PRICE INFLATION FALLING RAPIDLY
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10:30	BOE-FALL IN STG, MARKET INTEREST RATES AND RISE IN STOCKS COULD SUPPORT GDP, CPI
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10:30	BOE-INFLATIONARY PRESSURES SEEM TO BE BUILDING IN THE SUPPLY CHAIN
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10:30	BOE-CPI SEEN HITTING 2PCT TARGET IN 2YRS, RISKS SOMEWHAT TO THE DOWNSIDE
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10:30	BOE-KEY GLOBAL ECONOMIC RISK LIES IN OIL MARKET
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10:30	BOE-ANOTHER RISK IS POSSIBILITY OF SUBSTANTIAL FX MOVES LINKED TO US C/A DEFICIT
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- **Coverage of ECB press conference, November 4, 2004: 55 snaps, 14:31-15:17**

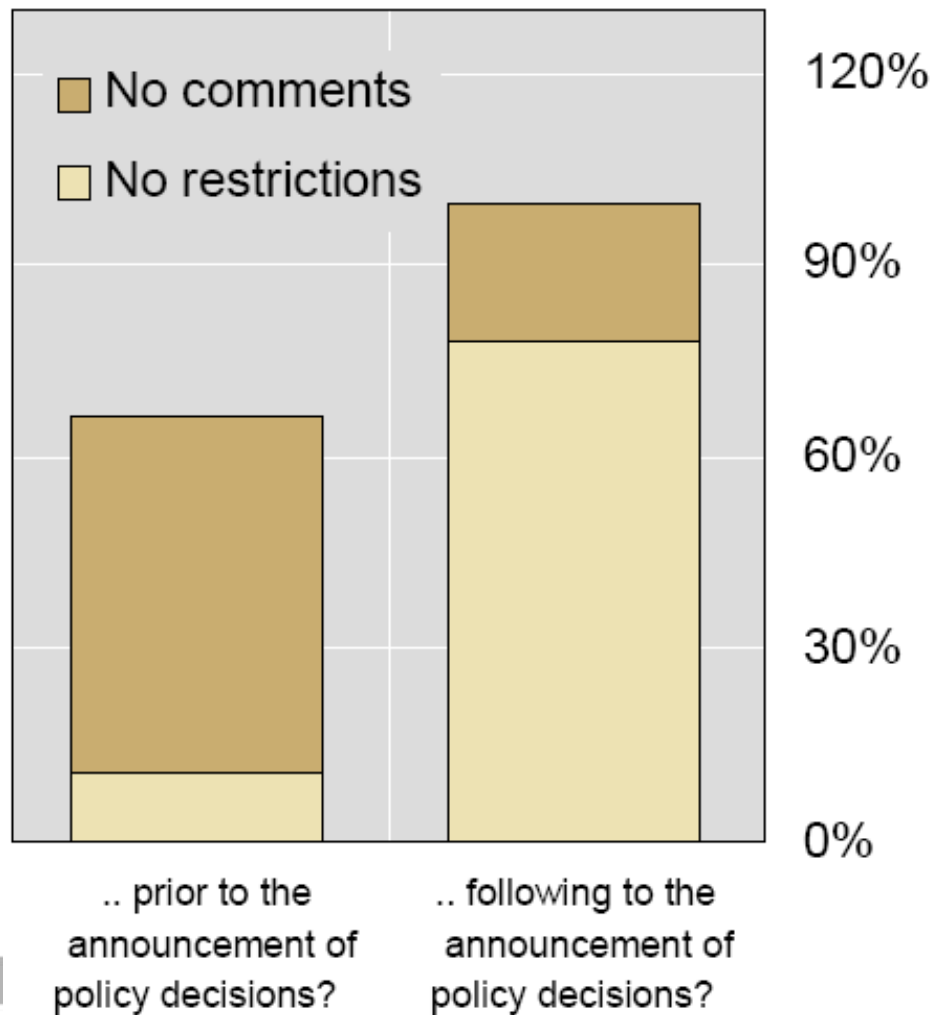


# The role of press conferences

- **Press conferences allow for instantaneous clarification**
  - **Survey of Asia-Pacific central banks (Filardo and Guinigundo 2008) shows that 78% hold press conferences, all with Q&A sessions**
  - **Clarification motive difficult to test for econometrically; indirect approach**
  - **Probability that market direction during Q&A differs from direction after release of decision is significantly elevated from 44% to 60% (Ehrmann and Fratzscher 2008)**

# Limits to communication: blackout periods

- In place in many central banks, sometimes also after policy meetings (Fed: 7 days before, 3 after; Riksbank: close to)
  - Survey of Asia-Pacific central banks (Filardo and Guinigundo 2008)



# Limits to communication: blackout periods

- **Justification**

**“MR. COYNE: ... to try to prevent all the speculation in the press and subsequently in the market about what the Committee would do.”**

- **Justification for post-meeting blackout?**

**“MR. BLINDER: The current blackout is a leftover from a time when we did not announce the decision when we made it. There was still some secrecy and there was a lot of speculation as to what the FOMC had done. Now there isn't and the post meeting blackout now seems like an anachronism.”**

**“MR. MOSKOW: I can see a blackout the week before. [...] After the meeting, I view us as having made a consensus decision; we are going to go out and try to explain it to people. I think that helps in the education of people and the better understanding of monetary policy.”**

*Source: Transcript of FOMC meeting January 31/February 1, 1995*

# Limits to communication: blackout periods

- **What are the effects? One can use the fact that there is some reporting during the blackout period**
- **EGARCH estimates: effects on 6-month interest rates**
- **Pre-FOMC purdah communication has enormous effects on interest rates, and raises volatility**

	coef.		<i>std.err.</i>
<b>MEAN EQUATION</b>			
Pre-FOMC Blackout	0.043	***	0.008
No Blackout	0.006	***	0.001
<b>VOLATILITY EQUATION</b>			
Pre-FOMC Blackout	0.102	**	0.042
No Blackout	-0.050	***	0.009

# Limits to communication: blackout periods

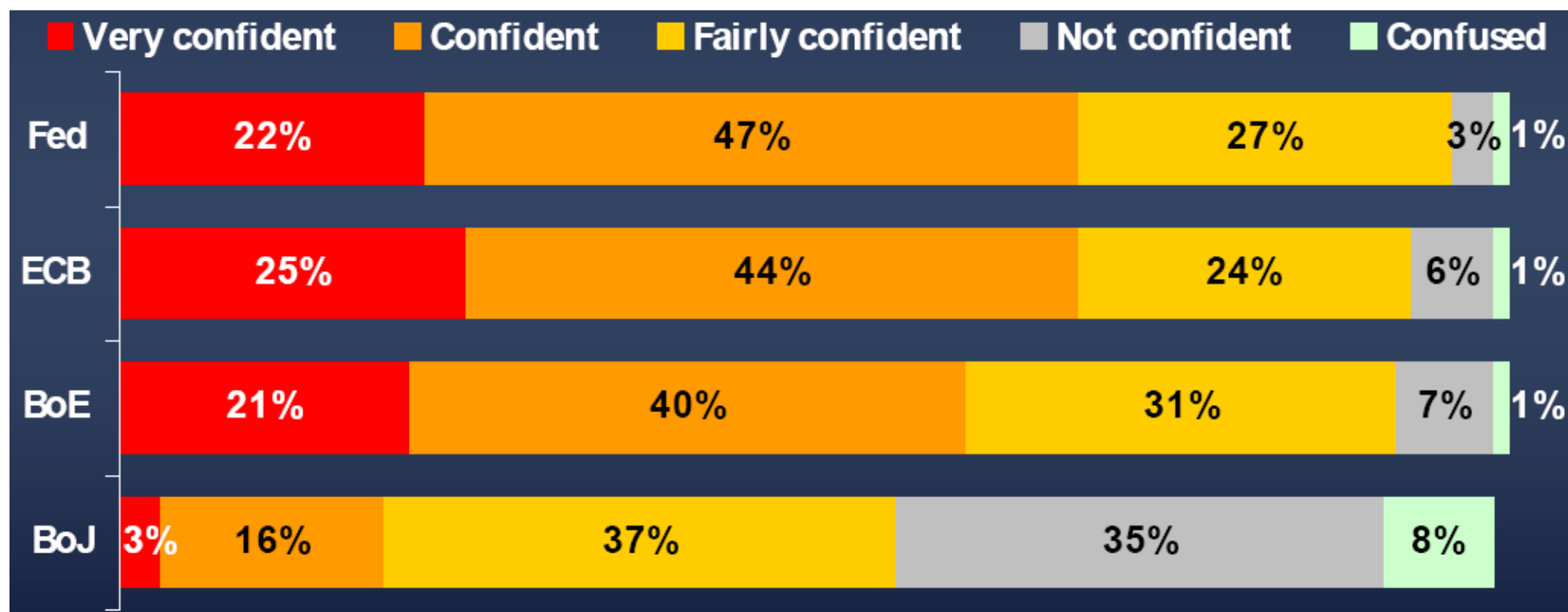
- **Post-FOMC purdah communication seems to be particularly beneficial after policy surprises**

	POLICY SURPRISE LAST FOMC MEETING				
	NO		YES		sig.
	coef.	<i>std.err.</i>	coef.	<i>std.err.</i>	
<b>MEAN EQUATION</b>					
Post-FOMC Blackout	0.009	<i>0.013</i>	0.506 ***	<i>0.000</i>	y
<b>VOLATILITY EQUATION</b>					
Post-FOMC Blackout	-0.419 ***	<i>0.117</i>	-1.129 ***	<i>0.417</i>	y

*Source: Ehrmann and Fratzscher 2008*

# What about the recipients' side?

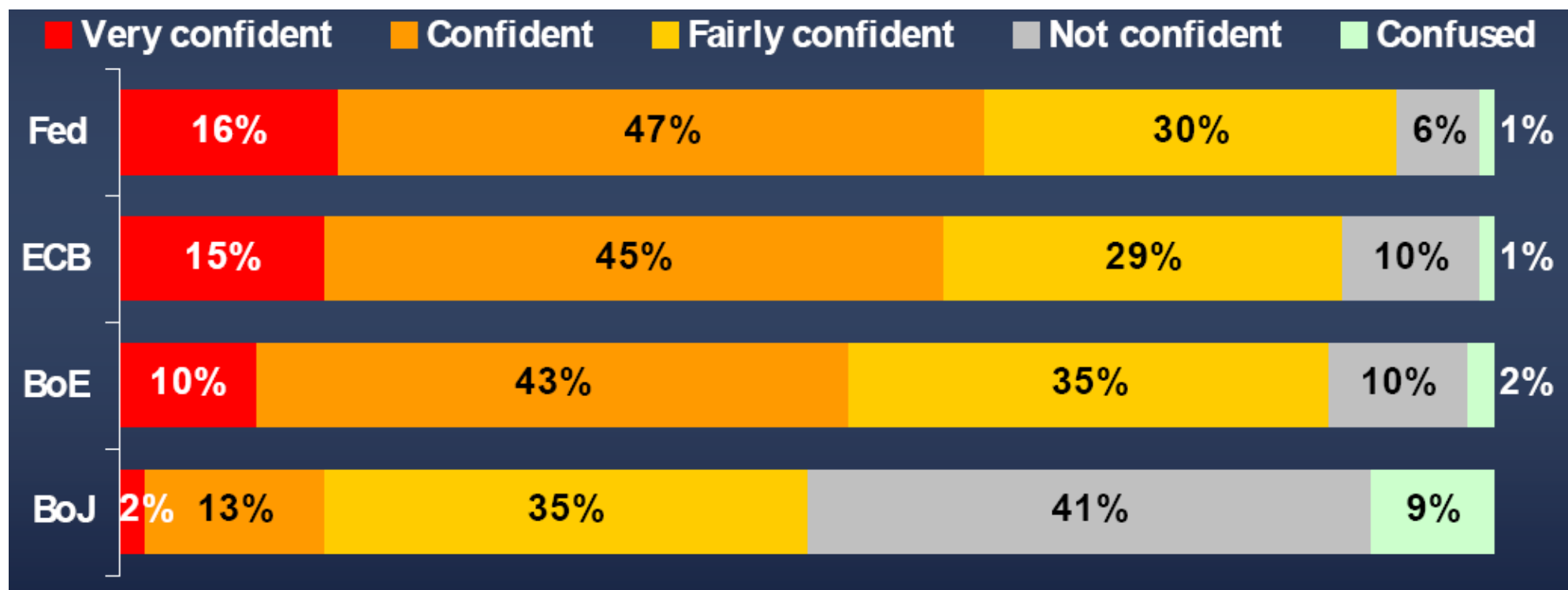
- **Barclays Capital Investor Survey of Central Bank Communication (2007)**
  - **Own confidence in understanding of central bank objectives**



*Source: Barclays Capital*

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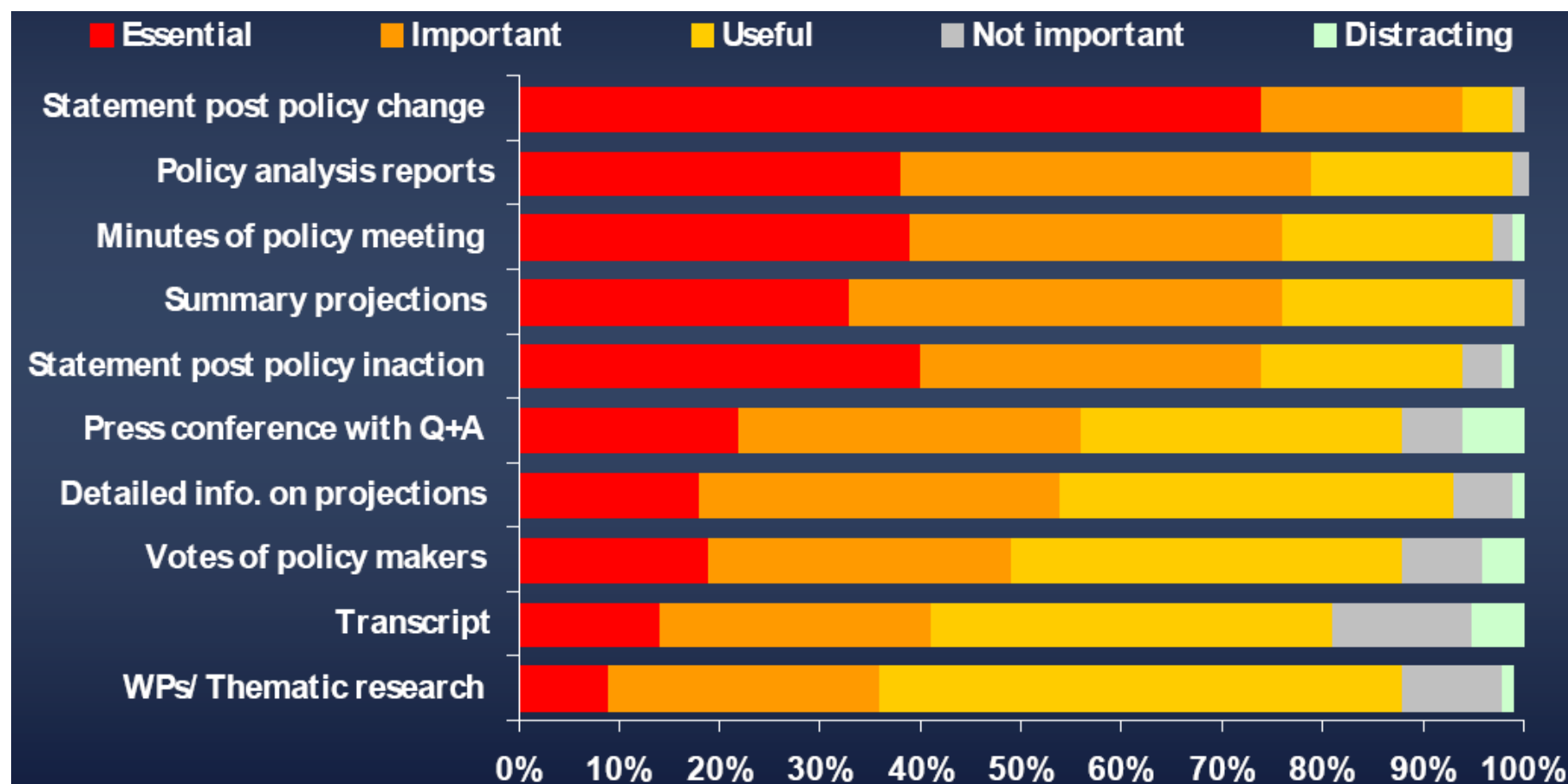
- **Barclays Capital Investor Survey of Central Bank Communication (2007)**
  - **Own confidence in understanding of central bank reaction functions**



*Source: Barclays Capital*

# What about the recipients' side?

- **Barclays Capital Investor Survey of Central Bank Communication (2007)**
  - **Importance of different communication vehicles**



Source: Barclays Capital



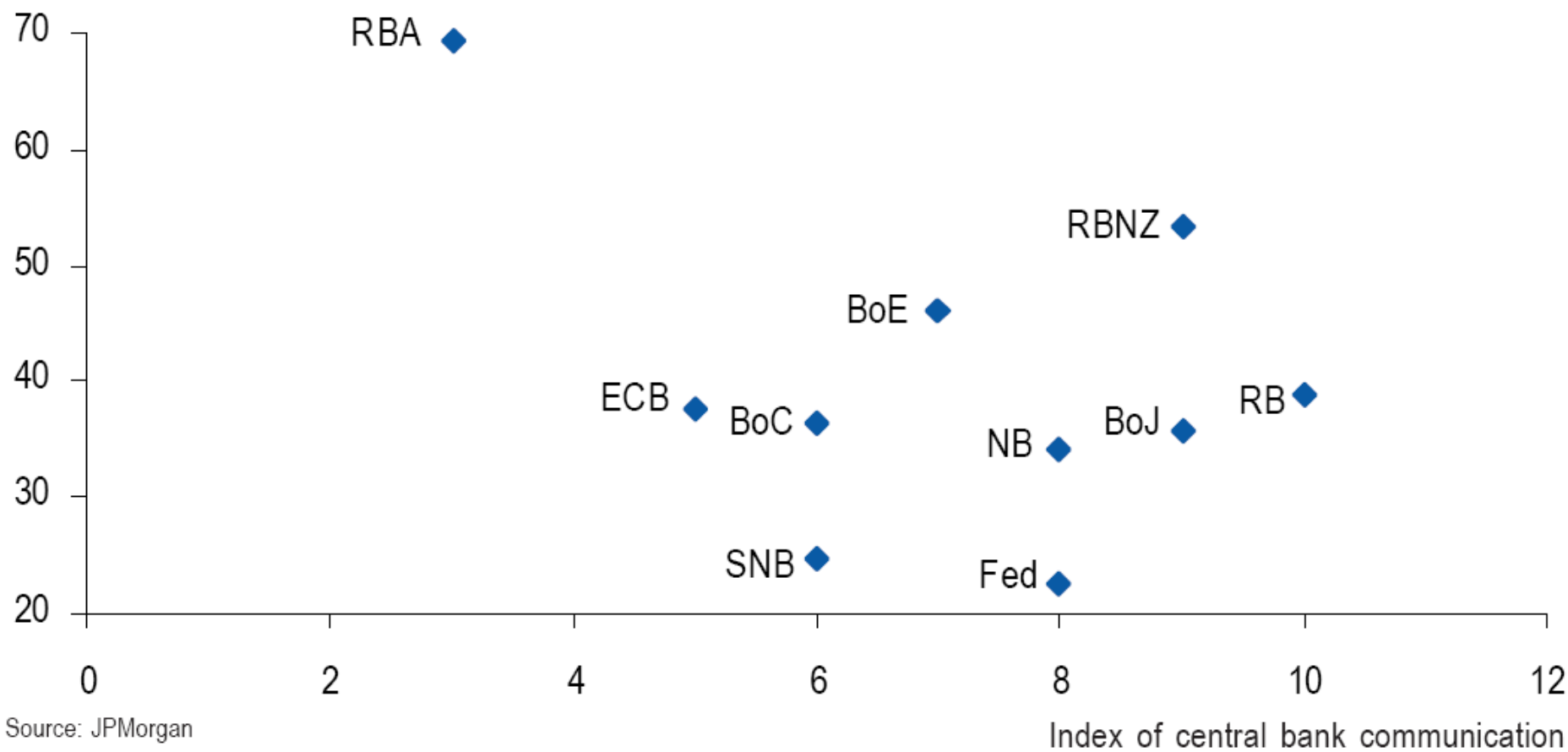
# What about the recipients' side?

- **Barclays Capital Investor Survey of Central Bank Communication (2007): Some comments by respondents**
  - **“Central banks communicate already too much with the market. Surprises are rare and should be part of our business - there isn't a free lunch. Otherwise we can sell potatoes.”**
  - **“Hopefully none of them follows xxx in becoming overly transparent and causing volatility in markets as a result.”**
  - **“Less transparency, I think, is what's needed now (we've crossed the Rubicon).”**

# What about the recipients' side?

- **JPMorgan (2007): “Central bank communication hits diminishing marginal returns”**
  - **6 month ahead forecast errors unrelated to communication policies**

Average error last 3 years, basis points



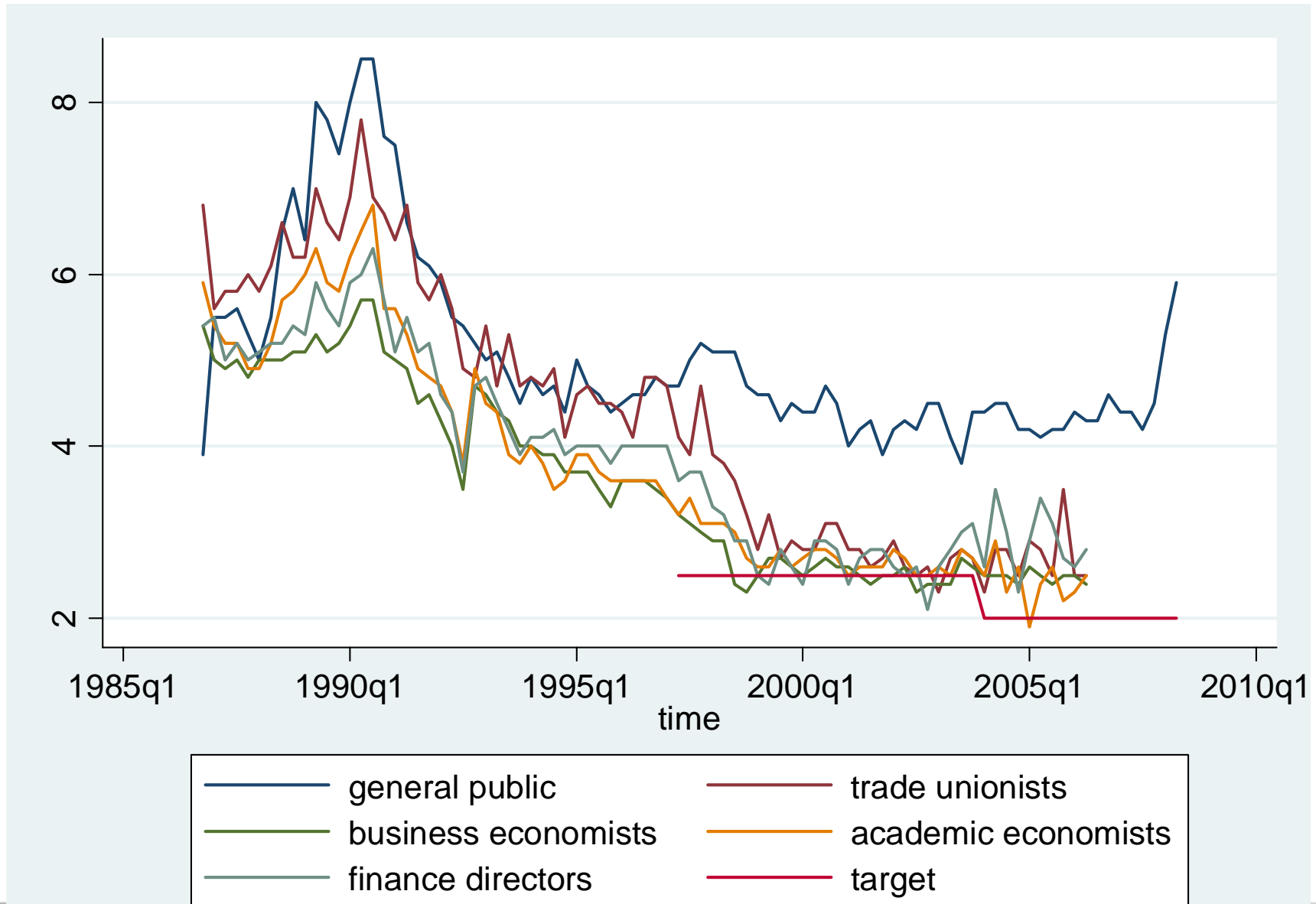
# Communication with other target groups

- **Barclays BASIX Survey of UK inflation expectations**
  - **What do you expect the rate of inflation to be over the next 12 months? And how about the following 12 months?**
  - **Average, 1986Q4 until 2006Q2 shows substantial (and partially significant differences)**
  - **General public and trade unionists have higher expectations**

	1 Year	2 Years
Business Economists	3.49	3.59
Academic Economists	3.60	3.78
Finance Directors	3.63	3.88
Trade Unionists	3.90	4.36
General Public	4.73	5.12

# Communication with other target groups

## Barclay's BASIX Survey of UK inflation expectations



Source: Barclays Capital

# Communication with other target groups

- **Bank of England/GfK NOP inflation attitudes survey**
  - Each month, a group of people meets to set Britain's basic interest rate level. Do you know what this group is?

	02/2000	02/2002	02/2004	02/2006	02/2008
Monetary Policy Committee	4	4	4	4	6
Bank of England	29	35	36	36	38
The Government	2	4	4	4	5
The Treasury	1	1	1	1	1
Parliament	*	*	*	*	1
Other	2	2	2	2	2
Don't know	62	54	54	53	48

*Source: Bank of England*

# Conclusions

- **Communication to financial markets**
  - **Close to efficiency frontier, biggest returns have been reaped**
  - **Some reasons to limit communication (pre-meeting blackout)**
  - **Remaining differences in strategies might be of second order importance; reflect a central bank's environment**
- **Communication to other audiences**
  - **At this point the more profitable investment?**
  - **Deserves much more study**