STUDY

Requested by the ECON committee

Monetary Dialogue Papers, February 2022

European Parliament

Communication in monetary policy

Policy Department for Economic, Scientific and Quality of Life Policies
Directorate-General for Internal Policies
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PE 703.339 - January 2022

EN

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Monetary Dialogue Papers
February 2022

Abstract

This paper examines the importance of communication of monetary policy in the light of the complex challenges central banks face post-GFC in their role as "crisis managers", confronting financial stability concerns, the economic consequences of the COVID-19 pandemic and the risks arising from climate change and unsustainable activities. Effective central bank communication becomes ever more critical in order to preserve credibility and legitimacy. Such communication is an important component of accountability. This paper does not deal with the supervisory function of the ECB; the focus is the monetary policy of the ECB.

This paper was provided by the Policy Department for Economic, Scientific and Quality of Life Policies at the request of the committee on Economic and Monetary Affairs (ECON) ahead of the Monetary Dialogue with the ECB President on 7 February 2022.

This document was requested by the European Parliament's committee on Economic and Monetary Affairs (ECON).

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Original: EN

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Manuscript completed: January 2022
Date of publication: January 2022

This document was prepared as part of a series on "Communication, complexity and credibility of monetary policy", available on the internet at:
https://www.europarl.europa.eu/committees/en/econ/econ-policies/monetary-dialogue

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For citation purposes, the publication should be referenced as: Lastra, R., Dietz, S., *Communication in monetary policy,* Publication for the committee on Economic and Monetary Affairs, Policy Department for Economic, Scientific and Quality of Life Policies, European Parliament, Luxembourg, 2022.

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LIST OF ABBREVIATIONS

ABSPP	Asset-backed securities purchase programme
BoE	Bank of England
BVerfG	Bundesverfassungsgericht (German Federal Constitutional Court)
CB	Central bank
CBPP	Covered bond purchase programme
CSPP	Corporate sector purchase programme
ECB	European Central Bank
ECJ	European Court of Justice
ECON	European Parliament's Committee on Economic and Monetary Affairs
ECCO	Eurosystem/ESCB Communications Committee
EP	European Parliament
FCA	Financial Conduct Authority
Fed	US Federal Reserve System
FOMC	Federal Open Markets Committee
FPC	Financial Policy Committee (of the Bank of England)
GFC	Global financial crisis
IEO	Independent Evaluation Office
IMF	International Monetary Fund
LFS	Labour Force Survey
MEP	Member of European Parliament
MPC	Monetary Policy Committee (of the Bank of England)
NCB	National Central Bank
OMT	Outright monetary transactions programme
PRA	Prudential Regulation Authority
PELTRO	Pandemic emergency longer-term refinancing operations
PEPP	Pandemic emergency purchase programme
PSPP	Public sector purchase programme
QE	Quantitative Easing
SMP	Securities market programme
TFEU	Treaty on the Functioning of the European Union
TLTRO	Targeted Longer-Term Refinancing Operations

EXECUTIVE SUMMARY

- **Central bank (CB) communication takes on different forms and works through different channels** in relation to the three key counterparts analysed in this paper: the legislators, the public and financial market participants.
- **Given the increased complexity of the considerations that inform monetary policy** and the broadening of the CB's mandate post global financial crisis (GFC), communication is ever more critical.
- **Central bank communication plays different functions**: "reflection", "translation", "management of expectations", "listening" and "legitimisation".
- **Communication with the legislators** has special significance because of the key role of parliamentary accountability in justifying central bank independence.
- In order to **strengthen the parliamentary scrutiny of monetary policy** we propose a series of measures to improve the Monetary Dialogue, including the creation of a specialised subcommittee within the ECON Committee and the establishment of an Independent Evaluation Office (IEO) at the European Central Bank (ECB). We also recommend enhanced transparency of monetary policy decisions and their effects, for example, with regard to the asset purchase programmes (QE).
- **Communication with the general public** contributes to societal legitimacy of the ECB. The support of the public – as a non-expert audience – is thus an element of *de facto* accountability of the ECB.
- **Communication with the financial markets** is essential for an effective and credible transmission of monetary policy decisions. It constitutes a two-way relationship, in which central banks signal to the markets and the markets react to those signals, sometimes amplifying or distorting them. This is a balancing act, requiring adequate calibration of the consequences of monetary policy decisions. E.g., the prolonged use of QE may generate a co-dependency between the central bank and the markets.
- **Central banks should tread carefully when they use "forward guidance" as an instrument of monetary policy** given the sensitivity of financial markets to central bank announcements.
- **The GFC, the COVID-19 pandemic and the risks arising from climate change** have accentuated the interdependencies and interactions between price stability, financial stability and public debt sustainability, complicating the conduct of monetary policy and its boundaries with fiscal policy.
- **To ensure that the ECB anchors inflation expectations** in accordance with its primary price stability mandate, the ECB should clearly communicate – and, where appropriate, publish – the considerations, motives and deliberations behind monetary policy decisions (in particular with regard to financial stability) so as to allow for effective parliamentary scrutiny and for an adequate understanding by financial markets and the general public. Monetary policy decisions need to be **motivated** if they are going to be revised by the ECJ or analysed by the European Parliament.
- **Clear and transparent communication about the interpretation of the secondary mandate** by the ECB (following the recent monetary policy strategy review) and its relationship with the primary mandate is essential in the exercise of effective accountability.

- **The ECB should consider revamping its Eurosystem/ESCB Communications Committee (ECCO),** or establishing a special task force, to enhance the public's understanding of monetary policy.
- **Communication is not only a fulcrum of monetary policy, but a tool to convey and ensure credibility**.

1. INTRODUCTION

Until the global financial crisis (GFC), communication about the monetary policy measures of the European Central Bank (ECB) was generally perceived as satisfactory and credible by financial market participants, by the public and by legislators. This was based, in part, on the anti-inflationary record of the ECB and, in part, on the broad acceptance by the main stakeholders (Member States and their citizens, EU institutions and financial markets generally) of the institutional design of the ECB, based on the principle of central bank independence. This institutional design – in line with the so-called "Tinbergen rule" of one agency (the central bank), one primary objective (price stability) and one main instrument (interest rate policy) – enhanced the credibility of monetary policy and facilitated communication.

From the early 1990s till the GFC this central banking model (the *model*) [1] became the norm not only in the EU but in many other countries around the world. The partial de-politicisation of the conduct of monetary policy served governments well and helped them navigate through the GFC. But the consensus around this *model* started to change with the GFC. Not only did central banks (CBs) such as the ECB, the Bank of England (BoE) or the US Federal Reserve System (Fed), enter uncharted territories with the use of unconventional monetary policy measures; they have also been facing unprecedented challenges given the complex dynamics between monetary, fiscal, and sovereign debt policies and the renewed emphasis on financial stability. That they managed to maintain their credibility when confidence was lost in the financial system at the peak of the GFC is a testimony to the validity of the *model*. Such credibility vis-à-vis political authorities and financial market participants is worth preserving, as advocated by the 2021 House of Lords Report on *Quantitative easing: a dangerous addiction?* (UK House of Lords, 2021) to which one of us (Lastra) contributed as Specialist Adviser.

Complexity in economic and monetary policymaking in the euro area is compounded by the different jurisdictional domains between a centralised monetary policy and decentralised fiscal policies and, since the adoption of Banking Union, by the dual responsibility of the ECB as monetary authority and supervisory authority of significant banks. Tension between different objectives, communication strategies and jurisdictional domains can also be observed in the responses to the pandemic and in the efforts undertaken to confront unsustainable risks arising from climate change and other activities (as part of the secondary mandate of the ECB).

A new model of central banking has emerged post GFC, one in which CBs have multiple objectives (price stability, financial stability and others) and functions (macroprudential policy and crisis management in addition to monetary policy, supervision, and others). Accordingly, CB communication has changed its role and its meaning in a myriad of ways.

First and foremost, communication has evolved from being a medium of simply informing the public or financial markets about what the CB has done in the past or will be doing in the future, to becoming a means of making monetary policy (an instrument referred to as "forward guidance"). Janet Yellen explains the rationale of forward guidance and the use of this new instrument and the communications by the Federal Open Market Committee (FOMC) [2]. She notes: *"A growing body of research and experience*

[1] The Bundesbank Law in line with this *model* influenced the Maastricht Treaty. Brunnermeier et al. (2016), at pp. 66–67 and 82 argue that the German approach, shared by northern EU Member States, is characterised inter alia by a focus on legal, moral, and political foundations of free markets expressed in clearly articulated rules; a strong emphasis on responsibility and accountability; a belief that binding rules are needed to shield monetary policy from fiscal dominance; a strict approach to government debt and debt ceilings; a conviction that growth is not achieved by provision of additional money but by structural reforms and a belief that present virtue—austerity—will be rewarded by future benefits.

[2] Yellen (2012): "The Committee stated that it expects a highly accommodative stance of monetary policy to remain appropriate for a considerable time after the economic recovery strengthens. And third, the Committee noted that it currently expects to hold the federal

demonstrates that clear communication is itself a vital tool for increasing the efficacy and reliability of monetary policy". She remarks that *"To fully appreciate the recent revolution in central bank communication and its implications for current policy, it is useful to recall that for decades, the conventional wisdom was that secrecy about the central bank's goals and actions actually makes monetary policy more effective"* and that this *"secretiveness regarding monetary policy decisions clashed with the openness regarding government decisions expected in a democracy, especially since Federal Reserve decisions influence the lives of every American."* As she recounts in her speech, the FOMC took a major step to explain its thinking when it issued for the first time in January 2012 a *"Statement of Longer-Run Goals and Policy Strategy which provides a concise description of the FOMC's objectives in conducting monetary policy and the approach the Committee considers appropriate to achieve them."*[3]

Second, the importance of communication as a source of democratic legitimacy and accountability has increased with CBs reinterpreting, expanding – and some argue overstepping – their mandates and/or the range of tools they deploy. CB communication has become an intricate exercise in balancing diverse, and at times competing interests to enhance policy effectiveness. With CB accountability being a compulsory corollary of their independence[4], expanded mandates create an ever greater need for accountability and clear communication.

Third, CBs need to understand, monitor and manage the expectations of financial markets and the public when conceptualising their monetary policy strategies. Central bankers have become increasingly aware of the growing importance of CB communication with markets and other audiences. They guide the market by means of communication and forward guidance. Holmes (2014b) noted that *"The incremental experiments with language and explanation pursued by the Fed over the last decade are setting a new relationship with the public, one in which ordinary people's predicaments are recognized and have come to serve as a fulcrum of policy. The days in which the leader of the Fed could mumble incoherently, obscuring his true intentions behind a cloud of verbiage, are gone."* [5] According to Yellen (2013), *"The Federal Reserve's ability to influence economic conditions today depends critically on its ability to shape expectations of the future, specifically by helping the public understand how it intends to conduct policy over time, and what the likely implications of those actions will be for economic conditions.(…). But the effects of today's monetary policy actions are largely due to the effect they have on expectations about how policy will be set over the medium term."* [6]

However, guiding the expectations is only possible if communication is constructed in a way which allows the market participants and citizens to understand the considerations behind the monetary policy measures. Conveying the intended monetary policy messages and information has become an

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funds rate at exceptionally low levels at least through mid-2015, about a half-year longer than previously announced. The three elements of forward guidance that were adopted by the FOMC in September 2012 would have been unthinkable in 1992 and greatly surprising in 2002, but they have, in my view, become a centerpiece of appropriate monetary policy." Yellen also notes: "The computation of an optimal path for monetary policy is obviously complicated, and, as I'll discuss, it's challenging to communicate. It rests on many assumptions about the outlook for the economy and its structure."

3 Ibid.

4 As explained in the paper submitted to the ECON Committee in 2020, accountability was an afterthought in such institutional design. See Lastra (2020).

5 We thank Holmes for helpful suggestions. In his book "Economy of Words. Communicative Imperatives in Central Banks" Holmes (2014a) explains how and why central bankers have learnt "to talk to markets" for only by effectively communicating with markets, can they justify their monetary policy decisions. In Chapter 3, entitled "Markets are a function of language", at p. 29 Holmes claims that "to understand the economy at large, it must be viewed as operating across an intricate communicative field". At p.216 he concludes: "The challenge for central bankers (…) is thus to navigate and manage the shifting grounds upon which members of the public become protagonists in the monetary drama".

6 See also Holmes (2014b): "For the last decade I've studied the behavior of policy makers at the Fed, the European Central Bank and the central banks of England, Germany, New Zealand and Sweden. Their leaders have for decades searched for a new conceptual anchor for monetary affairs—no longer gold or fixed exchange rates, but an evolving relationship with the public. Communication has become a fulcrum of policy. Policy makers shape expectations and, thus, economic behavior."

ever greater challenge when the rationale behind certain monetary decisions is the result of an increasingly complex deliberation of intersecting aspects.

Lastly, explaining and justifying monetary policy actions is fundamental for ensuring the credibility and legitimacy of independent CBs. Only if markets perceive the announcement of monetary policy measures as credible, will the CB be able to instil the confidence it needs to conduct an effective monetary policy. With the return of inflation and inflationary expectations this trust becomes essential. The testimony by Fed President Powell at his nomination hearing (2022) emphasises how monetary independence requires clear communication and transparency[7].

Following this brief introduction (Part 1) outlining the ways in which CB communication has changed, the paper analyses the effectiveness of the communication channels of the ECB with the public, the legislators and the financial sector (Part 2-4). It then addresses the communication challenges arising from the increased complexity and interaction between the objectives of price stability, public debt sustainability and financial stability and different policies (monetary, fiscal and macroprudential) in the pursuit of such objectives (Part 5). Finally, it concludes with some brief recommendations on communication designs to tackle communication challenges identified and, more generally, to improve accountability (Part 6).

This paper does not deal with the supervisory function of the ECB; the focus is the monetary policy of the ECB.

[7] See testimony by Powell (2022) at his nomination hearing before the Committee on Banking, Housing, and Urban Affairs, U.S. Senate: *"Congress has assigned the Federal Reserve important goals and has given us considerable independence in using our tools to achieve them. In our democratic system, that independence comes with the responsibility of transparency and* ***clear communication, to keep the public informed and enable effective legislative oversight. That duty takes on even greater significance when the Fed must take extraordinary actions in times of crisis.*** *(…)The Federal Reserve works for all Americans. We know our decisions matter to every person, family, business, and community across the country. I am committed to making those decisions with objectivity, integrity, and impartiality, based on the best available evidence, and in the long-standing tradition of monetary policy independence."* (emphasis added).

2. EFFECTIVENESS OF COMMUNICATION WITH LEGISLATORS, THE PUBLIC AND THE FINANCIAL SECTOR

Adequate CB communication enhances the effectiveness of monetary policy and contributes to legitimacy and credibility. Such communication comes into play through different types and channels in relation to the three key counterparts analysed in this paper: legislators, the public and financial market participants.

Communication plays different functions: i) "reflection", in which the institution itself gives an account of its own tasks as they evolve over time (this "reflection" can be observed in the monetary policy review undertaken by the ECB and similar exercises undertaken by the Fed and the BoE); ii) "translation", explaining in common parlance to the public the complex measures adopted (a feature of social media like Twitter) or the meaning of concepts such as "the transmission mechanism" of monetary policy; iii) "management of expectations" which is very important in the communication with financial market participants; iv) "listening" to the various stakeholders and, finally, v) the key function of "legitimisation" in which an independent technocratic agency explains why its actions serve the goal (or goals) and how it stays within the boundaries of its mandate[8].

2.1. Communication with legislators

Communication with legislators has special significance because of the fundamental role that parliamentary accountability plays in the justification of CB independence.

2.1.1. Locus and legal basis

The locus of parliamentary accountability for the ECB is European, not national.[9] The legal basis in the Treaty for the accountability of the ECB to the EP is Article 284 (3) of the Treaty on the Functioning of the European Union (TFEU) and Article 15 of the ESCB Statute.

The ECB can explain (hence, the importance of communication and education) to national parliaments the decisions it takes and their rationale. But this does not imply nor entail a duty to give account. As stated in the report written by Lastra for the European Parliament (EP) in September 2020: *"Draghi's practice of visiting national parliaments to explain the ECB's monetary policy decisions, engaging in an 'exchange of views' with elected representatives, should not be seen as an obligation (not even a soft obligation) to be accountable to national parliaments. It should simply be seen, in the spirit of cooperation (...), as educating European citizens about the role of the ECB."*[10]

The independence of the ECB is strongly protected by Article 130 of the TFEU as well as other Treaty provisions, such as the prohibition of monetary financing (Article 123 TFEU). Accountability is "the other side of the coin" of this independence in a democratic society. As advocated since 1992[11], an independent CB such as the ECB must be accountable to Parliament, to the judiciary and to the public

[8] This legitimisation is a central component of parliamentary accountability, see in more detail 2.1.2. Our thanks to D.A. Westbrook for interesting feedback on this point. The functioning of the modern world requires complex bureaucracies and experts, which not always fit easily under traditional models of democratic political understandings. Consider central bank independence which offers a bulwark against short-term but undue democratic influence over monetary policy. Or consider the culture of cryptocurrency; the ecosystem of "Bitcoin maximalists" is justified/legitimated by reference to the "evils" of traditional central bank monetary policy and governmental regulation.

[9] See Lastra (2020), p. 26.

[10] See Lastra (2020), p. 27.

[11] See Lastra (1992), pp. 481-482 and p. 519.

(*de facto* accountability). Only with adequate and diversified mechanisms of accountability can the institution be democratically legitimate, which is required by the principle of democracy, a fundamental basis of the EU, in accordance with Articles 2 and 10 of the Treaty on European Union.

2.1.2. Mechanisms of accountability

The EP holds the ECB to account through a number of mechanisms (the Monetary Dialogue[12], the Annual Report[13], appointment procedures[14], questions for written answer[15] and others[16]) which were explained in the report submitted by Lastra to the European Parliament's Committee on Economic and Monetary Affairs (ECON) in September 2020 (Lastra, 2020). Arguably, these mechanisms are not commensurate with the expansion of ECB tasks and tools post GFC and in response to the COVID-19 pandemic.

Some of the existing mechanisms of parliamentary accountability of the ECB were not spelt out in detail in the Treaty (for example, the Monetary Dialogue). But, as with so many other developments since the inception of the ECB, either by way of interpretation or implementation of Treaty provisions, normative solutions have legitimised the EU's and ECB's response to new operational needs or challenges and the expansion of tools and powers.

With power though comes accountability and any expansion in CB powers and extension of CB tools must be accompanied by an adequate expansion in accountability mechanisms. This can be done either by the amelioration of the existing instruments or by the adoption of new instruments via secondary law or interinstitutional arrangements[17]. The latter can contribute to a better balance between technocracy and democracy.

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12 See Lastra (2020), p. 24-25: "The primary law basis for the Monetary Dialogue is Article 284(3) TFEU. The Protocol on the Statute of the ESCB and of the ECB reasserts accountability to the European Parliament in Article 15(3). Formally, the Monetary Dialogue was set up by the European Parliament's Resolution on "democratic accountability in the third phase of EMU of 4 May 1998" which called for the organisation of a dialogue between the European Parliament and the future ECB on monetary and economic affairs, the framework for which dialogue should be confirmed through a mutual agreement" (See European Parliament (1998). See also Rule 135 of the Rules of Procedure of the European Parliament). Lastra's paper recommended that the "Monetary dialogue" be renamed as "Monetary hearings" reflecting the need for enhanced oversight and that a euro area subcommittee within ECON be established to scrutinise monetary policy more effectively.

13 In accordance with Article 284(3) TFEU the "ECB submits an annual report on its tasks, the activities of the ESCB and the Eurosystem's monetary policy to the European Parliament, the Council of the EU, the European Commission and the European Council. The report is presented annually to the European Parliament by the ECB President in a dedicated session of the ECON Committee and by the ECB President on the occasion of a plenary debate. The annual accounts of the ECB are part of the annual report".

14 See Lastra (2020), p. 25: "The European Parliament is also involved, in a consultative role, in the appointment procedures for the members of the ECB's Executive Board (and it has a veto right in the case of the Chair and Vice Chair of the Supervisory Board). In contrast to the ECB's supervisory function, beyond the Treaty provisions, there is no interinstitutional arrangement that formalises the ECB's accountability vis-à-vis the Parliament in the area of monetary policy."

15 All Members of the European Parliament can address written questions to the ECB, to better understand the CB's underlying motives and reasons for certain policy decision. There is no legal basis in the Treaty for these written questions. The applicable norm is Rule 140 of the Rules of Procedure of the European Parliament (see Rule 140 of the Rules of Procedure of the European Parliament (Questions for written answer to the European Central Bank). The answers to these questions are also published on the ECB's and the European Parliament's websites.

16 The European Parliament reacts to the Annual Report with a non-binding resolution to which the ECB gives feedback. See for example ECB, Feedback on the input provided by the European Parliament as part of its resolution on the ECB Annual Report 2019 in response to the European Parliament's Resolution on the ECB Annual Report 2019.

17 European Parliament (2021), para 34: "Echoes President Lagarde's openness to greater dialogue and stresses the need to further enhance the ECB's accountability and transparency arrangements; emphasises the need to reflect on how scrutiny of the ECB by the European Parliament as well as through dialogue with national parliaments may be enhanced; **calls for the negotiation of a formal interinstitutional agreement to formalise and go beyond the existing accountability practices regarding monetary functions."**

Effective communication can help reconnect normative legitimacy[18] and societal legitimacy[19]. While the ECB enjoyed societal support at the time of its creation, this support can wane or be questioned with the passage of time or when economic or political circumstances change**.**

Though accountability (*ex ante* and *ex post*) is always important, it can become a routine exercise in ordinary times. Accountability is, however, essential in extraordinary times to preserve societal legitimacy. If CBs overstep their mandates, or are perceived to do so, they lose credibility and endanger their legitimacy. This not only threatens the effectiveness of monetary policy but can also undermine the general trust in the commitment of the CB to fulfil its mandate, especially with regard to its price stability goal.

Transparency – a buzzword in central banking in recent years – is in some cases equated with accountability. But accountability is more than transparency: *"Transparency refers to the degree to which information on the decision and decision-making process has to be disclosed, being an integral part of accountability. (…) However, the provision of information is hardly ever a neutral account of what happened or of what is happening; hence, the need for an explanation or justification of the agency's actions or decisions (i.e., accountability). Thus, accountability must involve defending the action, policy or decision for which the accountable is being held to account."*[20]

CBs are becoming less secretive about their monetary policy activities. Yellen (2013) noted this as a departure from previous practice in a speech on *Communication in Monetary Policy*: *"Montagu Norman, governor of the Bank of England in the early 20th century, reputedly lived by the motto never explain, never excuse, and that approach was still firmly in place at the Federal Reserve when I went to work there as a staff economist in 1977."*

An accountable CB must explain the rationale and the considerations for adopting monetary policy measures (and the criteria of assessment) as well as the implications of the measures in the pursuit of the statutory or Treaty objectives (and the hierarchy of such objectives). At the EU, level this communication is essential given the distribution of competences in the areas of monetary policy (European) land fiscal policy (national).

The ECB has made a great effort over the years in becoming more transparent, publishing relevant information, as discussed in Lastra (2020)[21].

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[18] Legitimacy has a formal dimension related to the legal and political process and a societal dimension, related to the support by the public. See Verhoeven (2002), pp. 10-11: *"Legitimacy is constituted of two aspects: a normative, more formal notion, which refers to the legality of the political process and a societal, rather empirical notion, which is addressing the acceptance of the system."* There is no doubt that the ECB was established in accordance with the Maastricht Treaty, and thus, that its establishment is consistent with the formal understanding of legitimacy.

[19] Lastra (2015), Ch. 2, 2.163. An in-depth discussion of the concept of central bank accountability can be found in Lastra (2015), Ch. 2 and Ch. 7; Lastra and Shams (2001); Lastra and Miller (2001); Lastra and Amtenbrink (2008); Lastra and Garicano (2010); Lastra and Goodhart (2017).

[20] Lastra and Shams (2001). According to Scott (1996), D4.58: *"The importance (…) of the provision of full and adequate information is, in my opinion, self evident, whether in answering parliamentary questions or in debate or to a select committee. Withholding information on the matter under review, it is not a full account, and the obligation to account for what has happened or for what is being done has prima facie not been discharged.* ***Without the provision of full information, it is not possible for parliament, or for that matter the public, to hold the executive fully to account.****"* (emphasis added).

[21] As stated in ECB, Accountability and summarised in Lastra (2020), p. 30: *"Currently the ECB publishes: The Economic Bulletin (formerly Monthly Bulletin) which presents the economic and monetary information that form the basis for the Governing Council's policy decisions. It is published eight times a year, two weeks after each monetary policy meeting; The Eurosystem's consolidated weekly financial statement which provide information on monetary policy operations, foreign exchange operations and investment activities; The press conferences and the press statements which the ECB holds after each Governing Council monetary policy meeting setting key interest rates for the euro area, i.e. every six weeks and the monetary policy accounts of the Governing Council's discussions (which are published four weeks after each monetary policy meeting) (...), which were introduced in 2015 during Draghi's presidency".*

The parliamentary accountability mechanisms to which other CBs such as the BoE and the Fed are submitted provide examples of good practice in terms of democratic legitimacy and effective communication. E.g., the inquiry that the House of Lords undertook during the first half of 2021 into the QE program of the BoE (which led to the publication of the Report in July 2021, *Quantitative easing: a dangerous addiction?*) offers a commendable practice of parliamentary scrutiny of monetary policy. The inquiry focused around a single issue (QE), lasted for several months, thus allowing plenty of time to discuss the benefits and drawbacks of QE, and brought together a number of experts of the highest calibre in addition to current and former central bank governors and Treasury officials, to give oral evidence, answering a number of incisive questions prepared *ex ante* by the members of the Economic Affairs Committee of the House of Lords (some of the members are experts in monetary policy). The final "evidence-based report" was clearly written to reach out to the average citizen, explaining highly complex and technical matters in simple language, and emphasising *inter alia* the distributional (inequality) and other effects of monetary policy. The report's comprehensiveness reflected the breadth and depth of the inquiry, combining the results of the oral evidence received with the different sources of written evidence submitted by any interested party during the inquiry. This *modus operandi* of parliamentary accountability and information offering an extremely thorough scrutiny of a controversial and important monetary policy tool, could be replicated by MEPs participating in the Monetary Dialogue with the ECB.

Additionally, there are other mechanisms that can inform parliamentary scrutiny. In particular, effective audit control and the establishment of independent evaluation offices (IEOs) (like the ones that have been established at the BoE and at the IMF) provide a basis and input for subsequent parliamentary oversight and improve transparency.

In the UK, the IEO was established in 2014 as an independent unit that sits within the BoE to assess the Bank's performance. Though it is similar in nature to the IMF's IEO, its effectiveness to provide an adequate independent evaluation of issues related to the Bank has been questioned in some circles; perhaps it would be better if the BoE's IEO had been established as an external specialised institution.[22]

See Lastra ibid: "The intention of these accounts is not to provide a verbatim transcript but rather a summary of the Governing Council members' monetary policy discussions. *When a monetary policy decision is taken, the President of the ECB makes an introductory statement to the press conference and four weeks after the* ECB publishes an account of the Governing Council's monetary policy discussions to make the rationale behind the decisions more transparent. The account typically begins with an overview of the financial market and economic and monetary developments. The ECB Governing Council's discussions are then summarised, and economic and monetary analyses are presented along with the monetary policy viewpoints expressed. These monetary policy accounts do not report how individual members of the Governing Council voted or put names to comments made by individuals. Article 10.4 of the ESCB Statute prescribes that only the outcome can be published but not the minutes: "The proceedings of the meetings shall be confidential. The Governing Council may decide to make the outcome of its deliberation public." Furthermore, the voting records are not published in order to protect the personal independence of the members of the Governing Council, who could otherwise be subject to undue political pressure from the country/countries where they come from. It is for these reasons (the requirement of Article 10.4 ESCB Statute, the protection of personal independence and a civil law tradition of not publishing dissenting opinions to reinforce collegiality) that the ECB does not publish the minutes, nor the voting records nor the dissenting opinions."

22 In July 2019, the Court of the Bank of England commissioned the IEO to carry out an in-depth evaluation of the Bank's Asset Purchase Programme. The Report was published in January 2021, see Bank of England (2021), IEO evaluation of the Bank's approach to quantitative easing, and was quoted in UK House of Lords, Economic Affairs Committee (2021). One of the IEO reports relates to monetary policy forecasting and is available at https://www.bankofengland.co.uk/independent-evaluation-office. For a critique see Andrew Tyrie, written evidence (QEI0022) in the Quantitative Easing Inquiry (House of Lords, 2021), https://committees.parliament.uk/writtenevidence/36914/pdf/, page 12: "Probably (…) the Independent Evaluation Office could be turned into a more powerful and independent body, also with a **direct line of accountability to Parliament**".

With regard to the IMF, in addition to the IEO, which was established in 2001 (https://ieo.imf.org), Bradlow in a contribution to the Financial Times' Alphaville of 6 October 2021 (Bradlow [2021]) has recommended the appointment of an official Ombudsman independent of IMF management as a mechanism to enhance IMF accountability and to help the IMF learn from its own mistakes. The remit of this proposed Ombudsman (who would report to the IMF Executive Board) would be to investigate the conduct of the IMF and its compliance with its own policies and procedures, not to investigate or comment on its member states policies. In personal communication, Bradlow outlined the differences between the existing IEO and his proposed Ombudsman. First, the IEO focuses on reviewing completed IMF operations while the Ombudsman would deal with ongoing/current operations. Secondly, the IEO develops its

The IEO report on quantitative easing (QE) (Bank of England, 2021) stated: *"The public is (…) unclear about the extent to which QE is, or should be, used to finance Government borrowing. Given the UK's post-Covid fiscal position, a lack of public clarity on monetary financing could undermine the Bank of England's independence in the future."*

2.1.3. Challenges and potential for improvement

In the interaction between the EP and the ECB, improvements in communication and accountability can come via two main conduits: (1) internal organisation of the EP/ECON and (2) access to relevant ECB information and clarity in the considerations that affect the discretionary conduct of monetary policy.

In terms of the EP/ECON, (i) Members of the European Parliament (MEPs) in the ECON Committee have a very wide mandate, which may lead to a lack of time and focus; (ii) the composition and size of the ECON Committee and the need to coordinate (currently) seven political groups constitute another factor that can hinder the exercise of targeted monetary policy scrutiny. Thus a subcommittee of specialist MEPs dedicated to monetary policy matters would be an improvement over the current situation.

In terms of the ECB, (i) access to information is fundamental for the exercise of effective parliamentary scrutiny and, in this regard, the ECB needs to facilitate access for the EP/ECON to relevant non-public information so that MEPs can democratically scrutinise its monetary policy decisions; (ii) given the increased use of discretion in monetary policy matters post-GFC, evidenced by the variety of considerations that go into monetary policy decisions and the range of tools adopted by the ECB since 2007, there should be clear communication about the enhanced discretion applied in the flexibility of the "medium term orientation" to cater for other considerations - as stated in the ECB's new monetary policy strategy of 2021 - in the pursuit of price stability. The ECB should communicate clearly how financial stability considerations (and others) influence the "transmission mechanism of monetary policy".

In a speech on "Monetary Policy and Financial Stability" in December 2021, Isabel Schnabel (2021)[23] points out that: *"The birth of macroprudential policy was a recognition that price stability and micro-prudential policies were not sufficient to ensure financial stability, and that financial stability was a necessary precondition for price stability."* (…)*"[M]onetary policy needs to take financial stability considerations into account for as long as the macroprudential framework in the euro area is incomplete and not fully effective"*. Further she notes that: *"[I]n our recently concluded monetary policy strategy review, we explicitly recognised the potential financial stability risks that may accompany our policy measures"* and suggests that *"(t)he medium-term orientation of our monetary policy grants the flexibility required to tailor our policy response to the size, persistence and type of shock we are facing."* With these considerations in mind, she considers the decisions of the Governing Council in December 2020 as an example that illustrates the importance of financial stability considerations and explains that *"(b)y tolerating a potential lengthening of the medium-term horizon, we effectively mitigated risks to financial stability which could have arisen from a more intense use of our policy instruments."* While cautioning that: *"monetary policy must not be held hostage by fiscal or financial dominance"* she stresses that *"a thorough financial*

own work programme while the Ombudsman's investigations would be initiated by complaints by external stakeholders who allege that they are being harmed/threatened because of the IMF's failure to comply with its own operational policies and procedures. Thirdly, the structural relationship between the two is a matter for further discussion – there are good arguments for both incorporating the functions of the Ombudsman in the IEO and for establishing them as separate entities, both reporting to the Board.

[23] For legal considerations as regards the ECB's monetary policy strategy review see Ioannidis et al. (2021).

stability analysis is needed to inform the choice, design and calibration of the various monetary policy instruments that we use in the pursuit of our price stability mandate." Finally, she notes that: *"(t)aking financial stability considerations into account does not mean that financial stability is itself an objective of monetary policy. But there is a broad consensus that it is a precondition for achieving price stability."*

That financial stability is only a contributory task (Article 127 (5) TFEU) rather than an objective of monetary policy for the ECB greatly complicates communication, as it is denying the obvious ("The Emperor has no clothes…"). We come back to this issue in section 5.3.2 below.

Overall, the increasing complexity of the considerations that inform monetary policy (from financial stability to climate change beyond the traditional price stability rationale), the calibration of the appropriateness and validity of unconventional measures (their benefits and their side effects or unintended consequences), the assessment processes for calculating the amount of asset purchases, the technical deliberations that lead to monetary policy decisions (bearing in mind the limitations of the confidentiality provisions of Article 10(4) of the ESCB Statute) and the forecasting and modelling of macroeconomic developments in a changing environment exacerbate the existing information asymmetry between the EP (with a wide mandate) and the ECB (with a narrow primary mandate).

This development coincides with the need for a closer scrutiny of unconventional monetary policy measures and the effects of such measures on price stability, on the stability and efficiency of financial markets, on debt sustainability and on distributional justice (wealth inequality)[24], in particular when such measures may have spill-over effects into other fields of competences outside the ECB mandate[25].

Closer scrutiny depends on adequate information. EP/ECON accountability has to be reinforced to match the expanded range of tools and instruments the ECB has assumed alongside its crisis measures[26]. This necessity has also been endorsed by the EP in its Resolution of December 2021[27].

The German Federal Constitutional Court in its decision of 5 May 2020[28], asked for a more thorough reasoning of the ECB in its proportionality assessment and for more information on its decision making process, and disclosure of the considerations that inform monetary policy decisions. In this regard, the ECB provided a more comprehensive reasoning in its Governing Council Decision of 3-4 June 2020[29].

The European Court of Justice (ECJ) also stressed the procedural side of the discretion enjoyed by the ECB in the conduct of its monetary policy exclusive competence and the proportionality assessment in making the relevant considerations (that inform monetary policy decisions) transparent[30].

In order to reduce the information asymmetry between the ECB and the EP and to strengthen the scrutiny of ECB decisions by the EP, we suggest the following measures:[31]

- The Monetary Dialogue has to be conceptualised as a platform not only for the provision of information to MEPs but for the debate and scrutiny of the ECB actions. The ECB has to explain and justify the measures adopted. It should be less of a conversation, as the name "dialogue"

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[24] Some argue that very low interest rates and QE have fuelled a surge in asset prices, which mostly benefits the wealthy. See e.g., Cohen-Setton (2014).

[25] See UK House of Lords, Economic Affairs Committee (2021) and Coeuré (2018).

[26] Lastra (2020), p. 25.

[27] European Parliament (2021), para 34: *"Echoes President Lagarde's openness to greater dialogue and stresses the need to further enhance the ECB's accountability and transparency arrangements; emphasises the need to reflect on how scrutiny of the ECB by the European Parliament as well as through dialogue with national parliaments may be enhanced;* ***calls for the negotiation of a formal interinstitutional agreement to formalise and go beyond the existing accountability practices regarding monetary functions****."*

[28] See BVerfG, Order of the Second Senate of 18 July 2017 - 2 BvR 859/1 - ECLI:EU:BVerfG:2020:rs20200505.2bvr085915

[29] The German Federal Constitutional Court (2021).

[30] See ECJ, Judgment of the Court of 11 December 2018, Case C-498/17, *Weiss et al.*, ECLI:EU:C:2018:1000, para 30.

[31] Lastra (2020), p. 27 et seq.

might insinuate, and more of in-depth "hearings"[32] similar to the Congressional hearings in the US or the scrutiny undertaken by the House of Lords in its recent QE inquiry in the UK. The Monetary Dialogue, or rather the Monetary Hearings, should be a forum to challenge and discuss controversial ECB actions and decisions (without prejudice to the ECB's independence and wide margin of technical discretion in the exercise of its exclusive competence in monetary policy). "Hearings" of this nature would also attract wider media attention and thereby help to improve the communication channel with the general public.

- The Monetary Dialogue is the only platform for a direct two-way communication. While the ECB informs the EP with its Annual Report and other publications, the Monetary Dialogue gives the word to the MEPs and allows them to set the topics and to pose questions. This opportunity has to be used better by decisively choosing targeted, topical and also controversial topics, transforming the conversation from "a lecture" into "a debate"[33]. Only then would the EP be exercising adequately its duty to oversee and scrutinise the monetary policy of the ECB and the ECB would be in the position of explaining and justifying its measures (as the BoE was when the Governor gave oral evidence to the Economic Affairs Committee of the House of Lords in the QE inquiry in 2021)[34].
- A euro area specialised subcommittee within the ECON Committee[35] to conduct the Monetary Dialogue would be a way to build up more technical expertise[36] on the side of the MEPs. Although neither MEPs nor judges have to be monetary experts to conduct their parliamentary or judicial review, it is important that MEPs scrutinising monetary policy have or acquire sufficient knowledge to engage with the substance matter and to critically reflect and challenge the ECB's monetary policy measures. MEPs must therefore be equipped with some expert knowledge (coupled with the reliance on the papers prepared by the members of the Monetary Expert Panel) to avoid that knowledge asymmetry impedes the effectiveness of the Monetary Dialogue. The communication between the ECB and the EP should not be a top down lecture, but an in-depth debate among equals[37].

[32] Consequently, Lastra and de la Dehesa also advocate a renaming of the Monetary Dialogue to Monetary Hearings, see Lastra (2020), p. 27; de la Dehesa (2009): *"The ECON Committee should try to reach an agreement with the ECB President in order to transform the present Monetary Dialogue into a Monetary Hearing".*

[33] European Parliament (2014): "Earlier assessments of the Monetary Dialogue have often been critical. Academics have observed lack of forcefulness and insufficient qualification of MEPs; a tendency to talk cross-purpose; the absence of common grounds or concerns between ECB and EP, reinforced by the large size of the ECON; questions have covered less often monetary and more frequently fiscal policy; and on most issues the ECB holds the discursive monopoly. Nevertheless, in their study of previous parliaments, Eijfinger and Mujagic (2004) observed that in 71 % of the cases the ECB had implemented changes requested by ECON."; Lastra (2020), p. 28; Chang and Hodson (2019) also comment that the monetary dialogue would benefit from focusing on a narrower range of policy issues. Westbrook (2008), p.22, notes: "Reading from a script is not a conversation".

[34] See Lastra (2020), p. 28; Fraccaroli et al. (2020): "The tone of the deliberations may be driven by negative economic conditions, regardless of the central bank's ability to cope with them and some politicians may assume a more aggressive tone for electoral reasons, regardless of the central bank's performance in fulfilling the objective".

Interestingly, as reported in paragraph 46 of the House of Lords Report on QE (2021): "We heard that central banks take a more positive view of quantitative easing than independent analysts. Chris Giles told us that the Bank of England's analysis of how quantitative easing works had been inconsistent—with stress put on different transmission mechanisms in different rounds. He said that despite its inconsistencies, the Bank of England "never has any doubt that it is working although 'it has often changed the way in which it says it is working". And in paragraph 47: Daniel Gros said that there is "a certain bias in the available evidence", highlighting a recent paper for the National Bureau of Economic Research (Fabo et al., 2021) that set out how central bank research tended to show quantitative easing has a stronger impact on output and inflation than independent academic research. Pointing to the same research, Blonde Money, an independent macroeconomic research consultancy, said, "with central banks marking their own homework, the jury is still out on the success of quantitative easing."

[35] Lastra (2020), p. 28-29 and Chang and Hodson (2019) are advocating for the establishment of a euro area specialised subcommittee.

[36] Concerning the issue of technical expertise see Lastra (2020), p. 29; Lastra and Goodhart (2017).

[37] See also Lastra (2020), p. 28.

- Although the ECB is committed to transparency and, as an EU institution, obliged to ensure transparency with regard to its administrative tasks by Article 15 (3) par. 4 TFEU[38], the Treaties leave room for confidentiality beyond those areas that constitute administrative tasks. Accordingly, the ECB has set forth in its Decision on public access to documents that it shall refuse access to documents where disclosure would undermine the protection of the public interest as regards, for example, the financial monetary or economic policy of the Union and the internal finances of the ECB or of the national central banks (CBs)[39]. In the past, certain parameters of the ECB's purchase programme were kept confidential to ensure the effectiveness of the purchases. For example the exact volume, the considerations and the timing of the purchases are considered confidential information to ensure the conformity of the purchases with Article 123 TFEU. Confidentiality has also been extended to other decisions, especially those regarding the distribution and allocation of profits and losses resulting from purchase programmes. Whereas in covered bond purchase programme 1 (CBPP 1), covered bond purchase programme 2 (CBPP 2) and public sector purchase programme (PSPP) (as far as government and agency bonds are concerned) no decision on loss-sharing was taken, the ECB decided on a form of loss sharing among the NCBs according to the capital key for securities market programme (SMP), covered bond purchase programme 3 (CBPP 3), asset-backed securities purchase programme (ABSPP), Corporate Sector Purchase Programme (CSPP) and PSPP (as far as supranational bonds are concerned). Although the confidentiality of these decisions is granted by Article 15 (3) par. 4 TFEU and Article 4 of the Decision of the ECB on public access, one could question whether confidentiality is still warranted in these cases. Disclosing the profit and loss sharing arrangements should not undermine in principle the effectiveness of the conduct of monetary policy, though we are aware that they could be politically sensitive, as Member States could try to influence future monetary policy decisions if they know the impact those decisions may have in their respective NCBs since they have repercussion on the Member State budgets.

[38] Art. 15 (1) TFEU stipulates: "In order to promote good governance and ensure the participation of civil society, the Union institutions, bodies, offices and agencies shall conduct their work as openly as possible" and Art. 15 (3) Par. 3 TFEU: "Each institution, body, office or agency shall ensure that its proceedings are transparent and shall elaborate in its own Rules of Procedure specific provisions regarding access to its documents, in accordance with the regulations referred to in the second subparagraph". That this provision also applies to the ECB, yet only with regard to its administrative tasks, is enshrined in Art. 15 (3) Par. 4 TFEU: "The Court of Justice of the European Union, the European Central Bank and the European Investment Bank shall be subject to this paragraph only when exercising their administrative tasks."

[39] Art. 4 Nr. 1 (a) Decision of the European Central Bank of 4 March 2004 on public access to European Central Bank documents (ECB/2004/3) OJ L 80, 18.3.2004, p. 42–44, consolidated version 29/03/2015.The aggregate level of Asset Purchase Programmes (APPs) and of Pandemic emergency purchase programme (PEPP) is published at https://www.ecb.europa.eu/mopo/implement/pepp/html/index.en.html and https://www.ecb.europa.eu/mopo/implement/app/html/index.en.html There is also publication of the eligibility criteria of the assets included under each program and of the existence of "black-out periods" in purchase of public sector debt instruments in order to comply with the provisions of Article 123 TFEU.

3. COMMUNICATION WITH THE PUBLIC

Traditionally, communication with the general public regarding monetary policy decisions has been the channel most underappreciated and least taken care of by CBs.

When there is "societal support" for the primary mandate (as there was in Germany post WWII), the need for communication with the public is not as acute as when societal support for the goal of price stability is fractious. In order to build consensus, to enhance credibility and legitimacy, the CB must explain in clear language (avoiding technical jargon) what measures it adopts, why inflation is so detrimental for the economy and how the adopted measures serve price stability.

As discussed in Lastra (1992, p.519; and 1996, p. 49), this societal support constitutes an element of *de facto* accountability. The question is not why, but how CBs can communicate effectively with the public in the age of social media? Given the time lags of monetary policy, how can CBs explain monetary policy decision to non-experts in order to align the public "expectations" with its CB objectives? This is particularly important when CBs must adopt "unpopular measures", such as rising interest rates to fight inflation.

Until recently, the main audience CBs targeted with their communication strategies were the financial markets given their central role for the transmission of monetary policy impulses via interest rates (Gros and Capolongo, 2020). Not less important is the general public though, since the ECB's mandate is targeted at a certain inflation rate measured by a consumer inflation index. The ECB needs to manage households' and firms' inflation expectations to anchor wage pressures expectations, and to monitor their development (Duca et al., 2017; Gros and Capolongo, 2020). Also, expectations with regard to financial stability and the soundness of individual banks have proven to be crucial to prevent unfavourable chain reactions resulting into bank runs, as experienced during the financial crises. Consumer expectations also serve as a mirror for the success of the CB to anchor inflation expectations and ultimately for the credibility of the CB's signals (Duca et al., 2017).

Against this background, the public is much more than the mere recipient of monetary policy – it is an integral part of enacting and implementing the policy (Holmes, 2018). CBs around the world – including the ECB – have consequently increased their communication efforts with the general public. Besides the communication tools mentioned above (press releases and press conferences, monetary policy statements, the Economic Bulletin and the monetary policy accounts)[40], the ECB has entered the world of social media, with Twitter being the most important channel of communication so far. The ECB communicates via Twitter and currently has around 658,000 followers[41]. This represents a much broader audience than that of each NCB, although it still only constitutes a small portion of the general public (Gros and Capolongo, 2020).

In addition, the ECB took inspiration by the Fed's communication policies and created, during the monetary policy strategy review, the ECB Listens Portal, where the ECB gathered views, suggestion and concerns on a range of topics to better understand the perspective of the public on the economy and to also hear the expectations of the public towards the ECB[42].

[40] See above 2.1.2 and footnote 23.

[41] ECB Twitter account, accessed 19 January 2022. The ECB also uses Instagram and publishes a range of information for the non-expert public in its website.

[42] See ECB, Summary Report of the ECB Listens Portal. https://www.ecb.europa.eu/home/search/review/html/ecb.strategyreview002.en.html

The Consumer Expectation Survey, which piloted in January 2020 and has entered a second development phase in July 2021, is a testimony to the importance of expectations and perceptions of households in the euro area and their economic and financial behaviour. It collects respective data to improve the analytical basis for the ECB's economic and monetary and financial analysis[43].

3.1. Purpose and form

The content of the communication has to be tailored according to the recipient and the goal of the communication.

The broader public are not experts who are familiar with monetary policy terminology or have prior knowledge of this discipline. In consequence, the information has to be presented in non-technical terms with simple language.

The goal of communication with consumers and households is two-fold: (i) to assess, monitor and anchor inflation targets, and (ii) to create a general understanding of the ECB's monetary policy. Hence, the ECB needs to understand and decide which information fulfils which purpose: Is the communication mainly aimed at helping the general public understand better monetary policy in general or should a specific information be passed on about the monetary policy strategy with which the ECB wants to influence inflation expectations? In order to build trust in the CB's ability to fulfil its mandate – a necessary prerequisite for an effective monetary policy – it is fundamental to explain the mandate and the basic functioning of monetary policy with regard to specific measures adopted[44].

The content of the information has to be targeted to the “reaction mode” of the audience. Studies have found that non-experts only engage to a very small amount within the ECB-related Twitter traffic. Their opinions are generally stronger, more subjective and represent a larger variety of views compared to experts (Ehrmann and Wabtisch, 2021). Compared to experts, the general public also reacts with less lead time (Ehrmann and Wabtisch, 2021), which suggests that the reaction is not based on some thorough assessment of the relevant information or news, but is rather a sign of a prompt impulse. It is therefore not necessary, any maybe even counter-productive, to overwhelm the general public with too much granular information in high frequency[45]. Such information might be creating more confusion and is not addressing the interest of the recipients, who don't want to follow each day's monetary policy development, but understand the more general topics and trends. Communication should take place with less frequency and be reduced to general, abstract information on a strategic level[46]. Targeted messages in rather simple forms of communication have proven to be most effective in influencing consumers' inflation expectation (Coibion et al., 2019).

The process of monitoring the communication process is also key to ensuring that the ECB is able to disseminate adequate information. Studies analysing the retweet processes have come to the conclusion that strong views and more subjective reactions are more likely to be retweeted and hence more dominant in discussions and shaping the broader opinion spectra (Ehrmann and Wabtisch, 2021). The ECB should be actively involved in guiding those discussions to ensure their factuality (Ehrmann and Wabtisch, 2021).

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43 See ECB, Consumer Expectations Survey. https://www.ecb.europa.eu/stats/ecb_surveys/consumer_exp_survey/html/index.en.html

44 See also de Guindos (2019).

45 See also Gros and Capolongo (2020).

46 See also ibid.

Last but not least, communication with the general public is not only a one-way to transport information or messages to the public, but rather a two-way-channel (de Guindos, 2019), from which the ECB itself benefits: The reactions to the communication events of the ECB and the inflation expectations built by the public are a yardstick to gauge how far the public trusts the information coming from the ECB and ultimately contributes to the credibility of the ECB monetary policy (de Guindos, 2019). This credibility is not only important for the ECB's perceived legitimacy, but also for the effectiveness of the conduct of monetary policy itself.

The transmission mechanism relies on the reactions of the financial intermediaries and the consumers transmitting monetary impulses from the CB via the financial markets to the real economy. Since monetary policy relies on a voluntary behaviour of the relevant actors stimulated by the CB's impulses, trust in the communicated monetary policy strategy and the CB's commitment to its mandate is key to generate the intended reactions on the side of the consumers and households. Trust in the communicated policy strategy decreases doubts and uncertainties about future price developments and makes inflation expectations less volatile. Only if the public perceives the ECB and its monetary policy conduct as credible, inflation expectations will be anchored effectively[47]. Likewise, and as the bank runs during the GFC have shown, trust of the general public in the central bank is key to maintain financial stability.

In the function of "listening" the ECB should also pay attention to the expectations the public has towards the CB. Perspectives on how the ECB should act have been more than heterogeneous since the GFC and the pandemic crisis. While there is certainly room for discussion among experts concerning the appropriateness of certain ECB measures and the legal boundaries of the ECB's mandate, there are some undisputed baselines about the ECB's mandate which have to be understood by the public. Communication is therefore also an important means to clear misunderstandings or correct wrong expectations.

3.2. Challenges and potential for improvement

The effectiveness of these newly discovered modes of communication with the general public via social media have only been evaluated recently. While Blinder (2018) stated that *"central banks will keep trying to communicate with the general public, as they should. But for the most part, they will fail"*, more recent surveys paint a more positive picture on the success of the communication efforts (Gros and Capolongo, 2020; Ehrmann and Wabtisch, 2021). Studies found that the general public is responsive to ECB communication events which is demonstrated in corresponding ECB-related Twitter traffic in reaction to such ECB communication (Ehrmann and Wabtisch, 2021). There have also been events, especially with regard to tweets in German and in reaction to controversial ECB press conferences, which show that the general public is not only reacting with a single, short opinion, but also in a more persistent way ensuring that diverging opinions are not only expressed but also discussed (Ehrmann and Wabtisch, 2021). Although the ECB has not been able to build up communication with the non-expert audience to the same degree as with experts, the new channels show responsiveness and provide a platform for exchange (Ehrmann and Wabtisch, 2021).

Yet, the Eurosystem still faces some challenges when it comes to addressing the general public. Language barriers constitute one of these challenges. The communication of the ECB via Twitter is in English. While English is commonly understood, it is not the native language of all euro area citizens.

[47] See also Christelis et al. (2019).

NCBs have to start making more efforts communicating with their citizens (a mission of education) in their respective languages to make sure that monetary policy decisions, which by definition are rather technical in nature and concern policy matters with which the general public is not so familiar with, can be more easily understood.

Moreover, NCBs and ECBs should consider to be present in other social media besides Twitter and, for example, contribute to blogs targeted at non-expert audiences. NCBs should investigate in their respective Member States which platforms could be of value for monetary policy communication. The ECB is also offering a Q&A session on Twitter, which is a useful tool to understand what questions are important to the general public and to get into a more direct exchange. Giving the general public the option to directly pose questions should also be embedded in the NCBs' communication policies.

Monetary policy should also be taught by educational institutions. The ECB has already developed educational material about the ECB and its policies, which is available on the website. NCBs should follow this example and also try to address the relevant institutions in the Member States to enhance the educational process about monetary policy. Some NCBs, such as Banco de España, are increasing the resources to enhance better communication with the public via Twitter, YouTube and other social media, as well as initiatives to facilitate financial and monetary education [48].

Involving the general public in the ECB's work enhances interest in monetary policy. Efforts to communicate with the general public during the latest monetary strategy review are a prime example for such an involvement and should be carried on also in the future. It is important to signal to the EU citizens that they are not only recipients or addresses of EU monetary policy but an integral part for a successful price stability-oriented monetary policy.

[48] Banco de España has developed an educational website https://portaleducativo.bde.es/educa/es/menu/Videos/ and a plan of financial education together with the Spanish Securities Commission (CNMV). Better communication with the public is a key strategic object according to https://www.bde.es/f/webbde/SSICOM/20200115/planestrategico.pdf

4. COMMUNICATION WITH THE FINANCIAL SECTOR

Communication with financial market participants and with the experts in the field of finance and monetary policy – the financial sector – assumes a central role for CBs.

4.1. Function of communication with the financial markets

While this channel of communication has always gained attention by CBs (section 4.1.1), forward guidance has emerged as a monetary policy instrument of its own kind since the GFC (section 4.1.2).

4.1.1. Financial markets and financial stability

Communication with the **financial markets** implies a two-way relationship (de Guindos, 2019).

CBs pass on information to the financial markets in order to generate a certain behaviour in response. The more transparent CBs are with regard to their objectives and their reaction functions, the better the inflation expectations will be anchored and reflected in the prices of financial assets (Blinder et al., 2008). As Yellen (2013) points out: *"The Federal Reserve's ability to influence economic conditions today depends critically on its ability to shape expectations of the future, specifically by helping the public understand how it intends to conduct policy over time, and what the likely implications of those actions will be for economic conditions.(…). But the effects of today's monetary policy actions are largely due to the effect they have on expectations about how policy will be set over the medium term."* Markets can – or must – be therefore understood as a function of language (Holmes, 2014).

Markets have proven to be very sensitive to the CBs assessment of the financial and economic situation and the prognoses for future macroeconomic developments (Jarocinski and Karadi, 2020). Explaining and informing the financial sector about the short- and long-term policy strategies is essential to prevent volatility and to align inflation expectations with the CB policy objectives[49]. This insight holds true for the ECB's price stability mandate as well as for the contributory task in the realm of financial stability alike[50].

But neither are CBs only "speakers" or "policymakers" nor financial markets only "listeners" or "recipients" of monetary policy. Rather, CBs also assume the position of "listeners" with regard to the signals sent by the financial markets as relevant factors in the monetary decision-making process. Understanding market expectations about the economic outlook is crucial to develop a reliable monetary policy strategy that is addressing market needs. The market view and the CB view have to be cross-checked in order to send the right monetary policy signals on the side of the CB[51].

In the context of the euro area, financial markets ought to understand better the considerations that affect the decisions of the ECB Governing Council, in particular **how financial stability and sovereign debt concerns translate into monetary policy decisions.**

The practise of other CBs is heterogeneous when it comes to communicating how financial stability considerations are integrated in their monetary policy decision-making frameworks. The CBs in

[49] See also Blinder et al. (2008).

[50] See Powell (2018): "*There is also an important policy effectiveness argument in favor of transparency. In the financial stability arena, there is no better example of this than the role that the first round of stress tests played during the crisis in restoring confidence in the U.S. banking system. So in the financial stability realm, the case for enhanced transparency is not just about being accountable; it is also about providing credible information that can help restore and sustain public confidence in the financial system.*"

[51] See also de Guindos (2019).

Norway, Canada, Sweden, New Zealand and Australia explicitly take financial stability considerations into account within their inflation-targeting strategies. While the openness and frequency of reporting varied among these CBs, all of them made clear that financial stability was not a primary goal and that monetary policy would not address and counteract financial imbalances and risks at all costs and as a first line of defence (ECB, 2021b, p. 93).

Financial stability considerations have become integrated in the monetary policy decision making process of the FOMC (ECB, 2021b, p. 93). Since its monetary policy review in 2018, the Fed has been assessing the structural development of financial vulnerabilities and its consequences for the achievement of the Fed's dual mandate (Goldberg et al., 2020).

"Financial instability escape clauses" (Bank of England, 2013b, p. 38)[52] were included in the announcement in August 2013 of the Bank of England's explicit guidance regarding the future conduct of monetary policy (Bank of England, 2013a)[53]. While the these clauses have some advantages in making transparent when, under what circumstances and by which body financial considerations come into play within the monetary decision making process, the BoE has a dual mandate to maintain both monetary and financial stability and an institutional design with the MPC and the PFC aimed at pursuing both objectives, while financial stability is currently only a contributory task for the ECB in accordance with Article 127(5) TFEU.

4.1.2. Forward guidance

Communication is not only a means to influence the policy transmissions and a tool to gather information about the financial markets views and expectation. Since the GFC, it has developed into a monetary policy instrument of its own kind, with so called **"forward guidance"** being one its prominent examples. The term encapsulates a communication strategy which is aimed at achieving a

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[52] "At its meeting on 1 August 2013, the Monetary Policy Committee (MPC) agreed its intention not to raise Bank Rate from its current level of 0.5% at least until the Labour Force Survey (LFS) headline measure of the unemployment rate had fallen to a 'threshold' of 7%, subject to the conditions below. The MPC stands ready to undertake further asset purchases while the LFS unemployment rate remains above 7% if it judges that additional monetary stimulus is warranted. But until the unemployment threshold is reached, and subject to the conditions below, the MPC intends not to reduce the stock of asset purchases financed by the issuance of central bank reserves and, consistent with that, intends to reinvest the cashflows associated with all maturing gilts held in the Asset Purchase Facility. This proposition linking Bank Rate and asset sales to the unemployment threshold would cease to hold if any of the following three 'knockouts' were breached:

- in the MPC's view, it is more likely than not that CPI inflation 18 to 24 months ahead will be 0.5 percentage points or more above the 2% target;
- medium-term inflation expectations no longer remain sufficiently well anchored;
- the Financial Policy Committee (FPC) judges that the stance of monetary policy poses a significant threat to financial stability that cannot be contained by the substantial range of mitigation policy actions available to the FPC, the Financial Conduct Authority in a way consistent with their objectives."

See also ECB (2021b)

[53] The Bank declared that it "intends at a minimum to maintain the current highly stimulative stance of monetary policy until economic slack has been substantially reduced, provided this does not entail material risks to either price stability or financial stability. In particular, the Monetary Policy Committee (MPC) intends not to raise Bank Rate from its current level of 0.5% at least until the Labour Force Survey (LFS) headline measure of the unemployment rate has fallen to a threshold of 7%, subject to the conditions below." It then clarifies that the guidance linking Bank Rate and asset sales to the unemployment threshold would cease to hold if one of three so called "knockouts" were breached. Among these knockouts is also the "financial instability escape clause", which refers to the judgement of the Financial Policy Committee (FPC) that the stance of monetary policy poses a significant threat to financial stability that cannot be contained by the substantial range of mitigating policy actions available to the FPC, the Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA) in a way consistent with their objectives. Therefore, the MPC is allowed to deviate from its inflation target if the FPC formally judges and warns that attempts to keep inflation at target may pose a risk to financial stability.

See Bank of England (2013b, p. 38); Bank of England (2019, pp. 49-58); UK Treasury (2020). The "financial stability knock-out", based on the cooperation between the MPC and the FPC and only fulfilled if the FPC, the FCA and the PRA have exhausted their macroprudential tools to counteract financial stability risks. This mechanism assigns responsibility and accountability for the assessment of financial stability risks to the relevant bodies, and allows for a flexible, non-mechanical decision-making process, which nevertheless is transparent and clear with regard to policy outcomes and relevant considerations.

credible commitment to a certain behaviour of the CB in the future, often in relation to interest rates[54]. Its goal is to better manage market expectations and reduce uncertainties regarding the short- and medium-term monetary policy conduct[55]. This channel of transmission of monetary policy impulses is therefore also called the "signalling channel".

Forward guidance as an unconventional monetary policy instrument came into play when interest rates have reached the zero lower bound and conventional instruments lost their effectiveness[56]. The ECB only started this practice in 2013, when ECB President Draghi gave an outlook about the interest rate policy of the ECB in the medium term[57, 58]. Selmayr called this a "verbal interest rate intervention" which illustrates the potential impact of CB communication[59].

A prominent example for the significant effects of communication is the announcement via a press release of the outright monetary transactions programme (OMT). The fact that this announcement was challenged in front of the German Federal Constitutional Court[60] and the ECJ[61], is proof of the factual significance of communication[62]. which is recognised by the legal order by accepting communication (a press release) as a challengeable monetary policy instrument[63]. The announcement of OMT on 6 September 2012 was the result of a chain of communication events that also culminated in the advent of the Banking Union. On 26 July 2012, ECB President Draghi gave his famous "whatever it takes" speech, in which he did not announce specific measures, but expressed the general willingness of the ECB to do whatever it takes to solve the sovereign debt crisis at the time[64]. On 2 August 2012, the first explicit announcement of potential outright purchases followed[65], before the technical features of OMT were announced on 6 September 2012. Empirical studies illustrate that each of these announcements led to significant market reactions on the interday bid and ask rates for 2-year bonds on the respective OMT announcement days:

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54 See Lastra (2015), Ch. 2, 2.43; ECB (2014), p. 68, where different forms of forward guidance are discussed; Ceonen et al. (2017), p. 17 et seq.; Fiedler et al. (2016), p. 38.

55 Blinder et al. (2008), p. 6 et seq.; Ceonen et al. (2017), p. 6 et seq.

56 Lastra (2015), Ch. 2, 2.40.

57 In July 2013, ECB President Draghi announced in the Introductory Statement to the press conference on 4 July 2013: *"The Governing Council expects the key ECB interest rates to remain at present or lower levels for an extended period of time."*, Draghi (2013).

58 ECB (2014), p. 65; Hartmann and Smets (2018), p. 333; Fiedler et al. (2016), p. 12.

59 Selmayr (2014), Rn. 240.

60 See BVerfG, Judgement of the Second Senate of 21 June 2016 - 2 BvR 2728/13 - ECLI:EU:BVerfG:2016:rs2016060621.2bvr272813.

61 See ECJ, Judgment of the Court of 16 June 2015, Case C-62/14, *Gauweiler et al.*, ECLI:EU:C:2015:400.

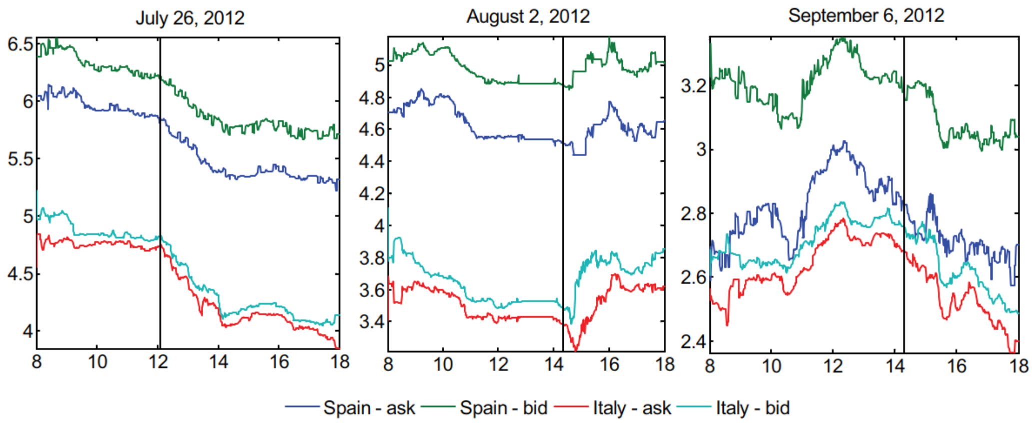
62 The ECJ emphasises in ECJ, Judgment of the Court of 16 June 2015, Case C-62/14, *Gauweiler et al.*, ECLI:EU:C:2015:400, para 79: *"Moreover, the ECB's assertion that the mere announcement of the programme at issue in the main proceedings was sufficient to achieve the effect sought — namely to restore the monetary policy transmission mechanism and the singleness of monetary policy — has not been challenged in these proceedings."*

63 See also ECJ, Judgment of the Court of 16 June 2015, Case C-62/14, *Gauweiler et al.*, ECLI:EU:C:2015:400, para 18 et seq.

64 Verbatim of the remarks made by Draghi (2012: *"When people talk about the fragility of the euro and the increasing fragility of the euro, and perhaps the crisis of the euro, very often non-euro area member states or leaders, underestimate the amount of political capital that is being invested in the euro. And so we view this, and I do not think we are unbiased observers, we think the euro is irreversible. And it's not an empty word now, because I preceded saying exactly what actions have been made, are being made to make it irreversible. But there is another message I want to tell you. Within our mandate, the ECB is ready to do whatever it takes to preserve the euro. And believe me, it will be enough."*

65 Draghi (2012), Introductory statement to the press conference (with Q&A): *The Governing Council extensively discussed the policy options to address the severe malfunctioning in the price formation process in the bond markets of euro area countries. Exceptionally high risk premia are observed in government bond prices in several countries and financial fragmentation hinders the effective working of monetary policy. Risk premia that are related to fears of the reversibility of the euro are unacceptable, and they need to be addressed in a fundamental manner. The euro is irreversible. (…) The Governing Council, within its mandate to maintain price stability over the medium term and in observance of its independence in determining monetary policy, may undertake outright open market operations of a size adequate to reach its objective. (…) Over the coming weeks, we will design the appropriate modalities for such policy measures."*

Figure 1: Market effects of OMT announcement



Source: Altavilla et al. (2016), Figure 6, p. 20.

4.2. Challenges and potential for improvement

"Forward guidance" has not always been able to reduce uncertainty or improve clarity in the transmission mechanism of monetary policy. The BoE experience with forward guidance in 2013 is a good demonstration thereof[66]. In August 2013, the BoE predicted that unemployment was likely to remain above 7% until mid-2016, when instead that threshold was reached already at the end of 2013[67]. As a result of the difficulties in understanding how the labour market was behaving, forward guidance took a step back and, in February 2014, Governor Mark Carney announced that the BoE would no longer tie its policy decisions to a particular indicator[68].

Moreover, communicating with the financial markets has also some inherent intricacies that have to be watched carefully and taken into account. Two aspects should be highlighted briefly.

First, the "echo chamber" effect, also called "feedback loop", might be a reason why signals perceived through communication with the financial markets might be misleading. This phenomenon is addressing the position of the ECB as a "listener", trying to understand market expectations and perceptions as a factor influencing its monetary policy. Yet, what the ECB "hears" might be sometimes less what markets think, but rather the ECB's own echo. If the ECB relies on these market signals, it might actually further amplify the signals, instead of adequately reflecting the actual market views. Therefore, as Shin (2017, p. 1) put it, "the louder the CB talks, the more likely it is to hear its own echo". This problem gets exacerbated the stronger forward guidance is, causing a potential cementation of market expectations (Ehrmann et al., 2019; Shin, 2017). This leads to the paradoxical situation that quality of information about market expectation might be decreasing, if the ECB is giving more forward guidance to increase market expectations and reduce volatility (de Guindos, 2019).

Proposing a solution to this problem is not straightforward. While reducing the amount of communication would be an effective tool to address the problem, communication is essential to manage market expectations and as a source of accountability and therefore not a valuable option

66 See Lastra (2015), Ch. 2, 2.43-2.44.

67 See Giles (2014a, 2014b).

68 See Financial Times (2014).

(Shin, 2017, p. 5). However, the CB has to take this effect into account when assessing market signals and be a careful listener (Shin, 2017).

Second, market signals can be "very noisy". Despite the positive effect of communication and forward guidance on anchoring expectations of market participants, expectations will never be static and always contain some noise, which might be distorting the actual market signals. CBs have to try to filter out those noises and extricate the reliable market signals (de Guindos, 2019); Shin, 2017).

Further, as explained in the UK House of Lords (2021) report on QE and in the oral evidence to the Economic Affairs Committee during the QE inquiry by Mohamed El-Erian, there is a sense of co-dependency, with markets feeling entitled to CB support:

> *"Dr Mohamed El-Erian (…), told us that markets are in a bubble in which "financial assets are totally decoupled from [economic] fundamentals." (Question 62) He said that the decoupling of assets from the real economy was a rational process because consistent central bank intervention through quantitative easing means that financial markets can take excessive risks in the knowledge that central banks will provide support if financial stability is threatened. He told us that the major risk is that this develops into an unhealthy co-dependency between central banks and markets. He added: "Not only do markets expect central banks to come in and repress any volatility, regardless of the source of that volatility, but they require it. They feel entitled to central bank support." (Question 63)."*

In sum, while communication both as a monetary policy instrument and as a source of understanding market views is important, it also has inherent limitations. The ECB needs to be aware of these limitations and compensate with other sources, as macroeconomic data, to build a reliable information basis for its monetary policy decisions (de Guindos, 2019; Cœuré, 2019).

5. CHALLENGES FOR CB COMMUNICATION DUE TO THE INCREASED COMPLEXITY AND INTERACTION BETWEEN PRICE STABILITY, FINANCIAL STABILITY AND PUBLIC DEBT SUSTAINABILITY

Ensuring effective communication of the ECB with the general public and the financial sector as well as adequate accountability vis-à-vis the EP becomes even more challenging in the light of the increased complexity of monetary policy and the interplay between monetary, fiscal and macroprudential policies.

In the context of the GFC, the COVID-19 pandemic and, as of lately, the risks arising from climate change, the interaction between the objectives of price stability, financial stability and public debt sustainability become far more complicated in the post-COVID world of high debt, high asset market valuations (QE) and environmental challenges.

5.1. Price stability, financial stability and public debt sustainability

The European economy has undergone profound changes in the last decade: the twin financial and sovereign debt crises in the euro area, the COVID-19 pandemic and ensuing economic fallout and the challenges of the digitalisation on the one hand and "greening" the economy and the financial system on the other hand. The ECB has not only been faced with the task of mitigating these crises with monetary policy measures, but also with a much more complex dynamic and interaction between price stability, financial stability and public debt sustainability.

While the interplay between monetary and fiscal policy has always been in the focus of CB policy, financial stability concerns were generally neglected until the GFC[69]. Systemic risk during the GFC was a rude awakening for CBs and the near total collapse of the financial system following the bankruptcy of Lehman Brothers triggered unprecedented measures of monetary and liquidity support by CBs and recapitalisation and fiscal support by the political authorities.

In the aftermath of the GFC, many CBs in advanced economies decided to strengthen financial stability considerations within their monetary policy decision-making frameworks[70] and some CB mandates have been expanded or re-interpreted to include more explicitly financial stability[71].

Macroprudential policy, which was strengthened in the aftermath of the GFC to address systemic risk, provides a line of first defence against the build-up of financial imbalances - especially in a monetary union, since financial cycles are not homogeneous across the different member states. Yet, monetary policy plays also an important role to prevent and address financial imbalances, as financial stability and price stability are closely interlinked. Financial stability is a precondition for price stability, since financial crises can impede the monetary transmission mechanism and lead to intensive de-risking and deleveraging, which negatively impact economic growth and inflation outlooks[72]. To a large extent, monetary policy and macroprudential policy go hand in hand and measures aiming at price stability and financial stability are complementary. In other situations, though, price stability and financial

69 See Lastra (2015), Ch. 3, 3.58 et seq.; Lastra and Alexander (2020), p. 12.

70 ECB (2021b), p. 93 with further references to various central banks.

71 Lastra and Alexander (2020), p. 10.

72 The interactions and interdependencies between price stability and financial stability are complex and not necessarily linear. The modelling of this relationship is beyond our field of expertise.

stability demand for diverging policies and are conflicting, when systemic risks are building up in an environment of low inflation demanding for expansive monetary policy for example. Instead of positively contributing to financial stability, monetary policy measures can also negatively affect financial instability[73].

Not only have the interdependencies and interactions between price stability and financial stability become more visible during the crisis. Also, fiscal considerations were very present in the monetary policy response to the sovereign debt crisis in the euro area. The sovereign debt situation of some euro area Member States did not only impact monetary policy because of its negative repercussions on the financial sector via the state-bank nexus. Sovereign bonds also play an important role in the transmission channel so that sovereign debt problems resulted into impediments for an effective monetary policy transmission and hence became a concern for monetary policy – a problem to which the ECB reacted for example with its OMT Programme[74].

Though monetary policy decisions always have fiscal consequences[75], reliance on unconventional monetary policy measures, especially large-scale public purchase programmes, brought fiscal and financial stability concerns to the fore; large holdings of public debt were and are kept on the balance sheet of the Eurosystem.[76] Monetary policy needs to be driven by the primary objective of price stability and not by the fiscal or financial needs of the Member States[77] - risks of fiscal dominance and/or financial dominance[78].

While the GFC demonstrated the importance of financial stability, the goals of growth and employment, as well as solidarity and sustainability have become very relevant in the context of the COVID-19 crisis.[79] And some of the issues raised during the GFC, notably the role of sovereign debt for monetary policy given the rising public debt deficits, have resurfaced during the pandemic, which have increased by 15-30% GDP[80] and the continuous expansion of QE.

The ECB responded to the COVID-19 with an even more expansionary monetary policy, complementing the expansionary fiscal policies in the Member States to counteract the pandemic crisis[81]. The ECB justified the adoption of these measures as means to ensure the effective functioning of the transmission mechanism and to mitigate the price deflation caused by the expansionary government lockdown measures[82].

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73 An in-depth analysis of the interplay between monetary policy and financial stability can be found in ECB (2021b), p. 19 et seq. and 38 et seq. with further references.

74 See Lastra (2015), Ch. 7, 7.47 et seq.

75 In a paper submitted to the EP in 2015 by Lastra et al. on "Interaction between monetary policy and banking regulation", p. 48 we wrote: *"There is a misleading, but commonly used, phrase about some Central Bank operations having 'quasi-fiscal' effects. All Central Bank operations on their balance sheet, and to affect the level and pattern of interest rates, have fiscal implications, perhaps especially the most traditional open market operations in Treasury Bills to adjust the official short-term interest rate. But there is now, following on from the post-GFC allocation of responsibility for financial stability, and for the manipulation of micro and macro-prudential instruments, a far wider allocation of non-traditional operational functions to Central Banks. It has been akin to the opening of Pandora's Box."*

76 Fiedler et al. (2020), p. 9.

77 Bonatti et al. (2020), p. 59; Wyplosz (2020), p. 88; Benigno et al. (2021), p. 9.

78 "Fiscal dominance" refers to a situation in which the central bank's monetary policy objectives are subjugated to fiscal objectives. See Hartwell (2021), p. 80 et seq.; Benigno et al. (2021), p. 9; Wyplosz (2021), p. 39.

79 Lastra and Alexander (2020), p. 12.

80 Wyplosz (2020), p. 88.

81 See Lastra and Alexander (2020), p. 17 et seq. with further references.

82 According to the ECB, the measures are designed to incentivise banks to lend more to businesses and individuals with the hope that this additional lending will create economic activity that will increase prices to the target level of about 2% retail price inflation.

Nevertheless, the adoption by the ECB of these new programmes – the pandemic emergency purchase programme (PEPP) (involving more flexible indirect purchase of Member State bonds), the targeted longer-term refinancing operations (TLTRO) and the pandemic emergency longer-term refinancing operations (PELTRO) (involving negative interest rate loans for banks) – can be challenged by some (and, indeed, many in, for instance, Germany support this view) with the argument that goal of price stability is only a "pretence" for an actual policy of economic support, providing subsidies and credit support in a way that falls within the remit of fiscal policy and does not constitute a monetary task[83].

The ECB might also have to justify the PEPP, PELTRO and TLTRO programmes in light of the proportionality principle and the necessity test, as explicated in the Weiss Judgment of the ECJ[84], which must be met in order to show that these measures are necessary to ensure the effective functioning of its monetary policy and to meet the price stability objective[85].

5.2. The ECB's new monetary policy strategy

The ECB has analysed the increased relevance of financial stability considerations in its latest monetary policy review, which is reflected in its new monetary policy strategy (ECB, 2021a):

> *"The monetary and financial analysis has significantly shifted in focus since the 2003 review in response to the challenges that arose during and after the global financial crisis. The monetary and financial analysis assigns an important role to examining monetary and financial indicators, with a focus on the operation of the monetary policy transmission mechanism, in particular via the credit, bank lending, risk-taking and asset pricing channels. Such assessments facilitate the identification of possible changes in transmission (for example related to structural factors such as the rise in non-bank financial intermediation) or impairments in transmission, for example owing to fragmentation or market stress. The monetary and financial analysis also provides for a more systematic evaluation of the longer-term build-up of financial vulnerabilities and imbalances and their possible implications for the tail risks to output and inflation. Moreover, it assesses the extent to which macroprudential measures mitigate possible financial stability risks that are relevant from a monetary policy perspective. The monetary and financial analysis thus recognises that financial stability is a precondition for price stability."*

The ECB examined different options to enhance the role of financial stability considerations in its monetary policy strategy. Two key elements were eventually included in the reviewed monetary policy strategy.

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83 For example, Paul Kirchhof, former Justice of the German Constitutional Court, argues that the ECB is actually conducting economic policy to ease financing conditions of the highly indebted states: "Doch jetzt überschreitet sie mit dem Nullzins und dem Negativzins ihren Auftrag zur Währungspolitik und betreibt Wirtschaftspolitik, um den überschuldeten Staaten billige Kredite und sogar finanzielle Anreize zur weiteren Verschuldung zu bieten. Ein solcher Akt jenseits der zugebilligten Kompetenz der EZB überschreitet die europarechtlichen Grenzen der Staatsverschuldung", see Schrörs (2021). Also the Economic Committee of the German CDU-Party argues that the ECB is willingly using Corona as a pretence for its monetary policy (ibid.). Another constitutional complaint against the PEPP has been brought before the German Constitutional Court and plaintiff Markus C. Kerber argues that the PEPP's relation to monetary policy is not visible any more, see Zschäpitz (2021). For a discussion on this, see Lastra and Alexander (2020), p. 19.

84 It can be argued that the ECJ finally put an end to the use of wide-ranging indirect measures with its ruling in the Weiss case by holding that the proportionality principle should apply to determine the legal limits on the use of such tools and that proportionality requires that such tools are "necessary" to achieve the price stability objective. See Lastra and Alexander (2020), p. 19.

85 Lastra and Alexander (2020), p. 18-19.

One element is to use the flexible length of the medium-term horizon, which is applied to the task of ensuring price stability, to better accommodate financial stability goals [86]. This would give room for longer deviations from price stability in the short- or medium-term with the aim of mitigating financial imbalances and vulnerabilities within this time frame and ultimately also benefit price stability in the long run. However, this option faces some severe downsides, as adjusting the length of the medium-term would result in impractically lengthy periods of deviation from price stability and could lead to a de-anchoring of inflation expectations[87].

Another element is the new "integrated analytical framework" which replaces the old "two-pillar" framework. In effect, the monetary analysis pillar is replaced by a "monetary and financial analysis[88]. The goal was to broaden monetary policy indicators and to better monitor the development of financial imbalances and vulnerabilities. The information given to the Governing Council as the basis for its decision-making process is extended in order to better understand and monitor potential financial imbalances which would negatively affect output and inflation also beyond the medium-term and to include the already enacted or planned macroprudential policies and their interaction with CB measures into the assessment[89].

5.3. Challenges for communication, accountability and credibility

5.3.1. Increased necessity of communication and accountability

Financial markets need to understand the monetary policy decision-making process and how the ECB considers to what extent and with what consequences other factors, such as sovereign debt sustainability or financial stability, in order to be able to form expectations and build trust in the ECB's policy.

If monetary policy is a 'black box' for the financial markets and if the hierarchy of monetary policy objectives and the way the ECB will weigh other considerations against price stability is non-transparent, market participants won't understand what CB behaviour to expect in relation to a given macroeconomic situation. That makes it in turn more difficult for the ECB to manage and anchor inflation expectations, to forecast market behaviour and effectively and credibly safeguard price stability.

86 ECB (2021a): "A medium-term orientation allows the Governing Council to cater in its monetary policy decisions for other considerations relevant to the pursuit of price stability... For example, the medium-term orientation provides flexibility to take account of employment in response to economic shocks, giving rise to a temporary trade-off between short-term employment and inflation stabilisation without endangering medium-term price stability. It also allows the ECB to take account of financial stability, where appropriate, in view of the interdependence of price stability and financial stability. The use of such flexibility could also be the result of a careful proportionality assessment of the appropriate policy measures..."

87 See in more detail ECB (2021b), p. 61 et seq.

88 ECB (2021a): "The monetary and financial analysis assigns an important role to examining monetary and financial indicators, with a focus on the operation of the monetary policy transmission mechanism, in particular via the credit, bank lending, risk-taking and asset pricing channels. Such assessments facilitate the identification of possible changes in transmission (for example related to structural factors such as the rise in non-bank financial intermediation) or impairments in transmission, for example owing to fragmentation or market stress. The monetary and financial analysis also provides for a more systematic evaluation of the longer-term build-up of financial vulnerabilities and imbalances and their possible implications for the tail risks to output and inflation. Moreover, it assesses the extent to which macroprudential measures mitigate possible financial stability risks that are relevant from a monetary policy perspective. The monetary and financial analysis thus recognises that financial stability is a precondition for price stability."

89 See in more detail ECB (2021b), p. 85 et seq. Coordination between monetary and macro-prudential policy in the Bank of England is reflected in the current remit of the Bank, UK Treasury (2020): "In order to foster coordination between monetary and macroprudential policy, there is overlap between the membership of the Monetary Policy Committee and the Financial Policy Committee. To enhance that coordination, where appropriate, the Monetary Policy Committee should reflect, in any statements on its decisions, the minutes of its meetings and its Monetary Policy Reports, how it has had regard to the policy actions of the Financial Policy Committee. In the same way, the government had also asked the Financial Policy Committee to note in the records of its meetings, its policy statements and its Financial Stability Reports how it has had regard to the policy settings and forecasts of the Monetary Policy Committee."

Clear communication is not only important for an effective monetary policy. It is also crucial to ensure a continuous accountability towards the general public and the EP. Especially when CB mandates are stretched, re-interpreted or one might say "enrichened" by other considerations besides price stability, it is important that effective accountability mechanisms are in place to ensure that the ECB is not diverging from price stability as its primary mandate and that the boundaries of its mandate are not over-stepped. If independent institutions were to act outside their field of competence without adequate supervision and legitimacy, independence - a "virtue" for price stability - could turn into a "vice". It is therefore in the interest of the CB itself to maintain its credibility and its commitment to price stability in order to justify its institutional independence.

5.3.2. Mandate of the ECB: objectives and boundaries

In order to understand the "content" of communication, it is important to recall the objectives and boundaries of the ECB's mandate. These must be reflected in accountability mechanisms and should be considered a prerequisite in any communication strategy:

- **Price stability as the primary objective (Article 127 (1) 1 TFEU).**

  According to Article 127 (1) 1 TFEU, the primary objective of the ECB is price stability[90]. Only without prejudice to this objective, the ECB shall support the general economic policies in the Union. The ECB's exclusive competence is monetary policy. The treaties have thereby established a clear hierarchy of objectives[91].

- **The support of the general economic policies in the Union as the secondary objective.**

  The ECB only has a contributory competence in the field of economic policy, which lies in the residual competence of the Member States. The ECB may (only) support the general economic policies in the Union, also known as the ECB's "secondary objective" (Article 127 (1) 2 TFEU)[92]. Fulfilling this secondary objective may not interfere with the ECB's primary objective[93].

- **Financial stability as a contributory task**.

  Article 127 (5) TFEU sets out the duty of the ECB to contribute to the smooth conduct of policies pursued by the competent authorities relating to the stability of the financial system[94].

- **The prohibition of monetary financing (Article 123 TFEU) and "fiscal dominance".**

  Article 123 TFEU prohibits the ECB from financing government obligation[95]. Large-scale purchases of sovereign bonds on secondary markets may not amount to monetary financing of sovereign debt[96]. The prohibition of monetary financing contributes to the protection of the

90 Art. 127 (1) 1 TFEU: "The primary objective of the European System of Central Banks (hereinafter referred to as 'ESCB') shall be to maintain price stability."

91 See Lastra (2015), Ch. 7, 7.25 et seq.; Lastra and Alexander (2020), p. 10-11.

92 Art. 127 (1) 2 TFEU: "Without prejudice to the objective of price stability, the ESCB shall support the general economic policies in the Union with a view to contributing to the achievement of the objectives of the Union as laid down in Article 3 of the Treaty on European Union."

93 See Lastra (2015), Ch. 7, 7.25 et seq.; Lastra and Alexander (2020), p. 11 et seq.

94 Art. 127 (5) TFEU: "The ESCB shall contribute to the smooth conduct of policies pursued by the competent authorities relating to the prudential supervision of credit institutions and the stability of the financial system." That financial stability is a contributory task rather than an integral part of the mandate of the ECB is rooted in this Treaty provision. As stated above in 2.1.3, this state of affairs is somehow denying the obvious (hence "The Emperor has no clothes…") since the twin mandate of modern central banks post GFC should be price stability and financial stability.

95 Art. 123 (1) TFEU: "Overdraft facilities or any other type of credit facility with the European Central Bank or with the central banks of the Member States (hereinafter referred to as "national central banks") in favour of Union institutions, bodies, offices or agencies, central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of Member States shall be prohibited, as shall the purchase directly from them by the European Central Bank or national central banks of debt instruments."

96 Fiedler et al. (2020), p. 9.

financial and institutional independence of the ECB by preventing fiscal dominance, which is undermining a price stability orientated monetary policy[97]. The ECJ has set forth further guidelines on the interpretation of Article 123 TFEU and its application to purchases of government bonds on the secondary market, which can amount in effect to monetary financing[98].

- **Proportionality and the obligation to "state reasons".**

  The ECJ and the German Federal Constitutional Court have both emphasised the need of the ECB, as an independent institution which enjoys substantial discretion in its monetary decisions, to state its reasons according to Article 296 (2) TFEU[99]. Especially with regard to the principle of proportionality enshrined in Article 5 (4) of the Treaty of European Union[100], the ECB has to make its deliberations, its rationale and decision-making process transparent[101]. Decisions need to be **motivated** if they are going to be revised by the Court of the Justice or analysed by the European Parliament.

97 See Lastra and Alexander (2020), p. 15 et seq.

98 ECJ, Judgment of the Court of 11 December 2018, Case C-493/17, *Weiss et al.*, ECLI:EU:C:2018:1000). See also ECJ, Judgment of the Court of 16 June 2015, Case C-62/14, *Gauweiler et al.*, ECLI:EU:C:2015:400. See Lastra and Alexander (2020), p. 15 et seq.; Grund (2020); Tridimas and Xanthoulis (2016), p. 28 et seq.; Bateman (2020).

99 Art. 296 (2) TFEU: *"Legal acts shall state the reasons on which they are based and shall refer to any proposals, initiatives, recommendations, requests or opinions required by the Treaties."*

100 Art. 5 (4) Treaty of European Union: *"Under the principle of proportionality, the content and form of Union action shall not exceed what is necessary to achieve the objectives of the Treaties."*

101 See ECJ, Judgment of the Court of 11 December 2018, Case C-498/17, *Weiss et al.*, ECLI:EU:C:2018:1000, para 30; BVerfG, Order of the Second Senate of 18 July 2017 - 2 BvR 859/1 - ECLI:EU:BVerfG:2020:rs20200505.2bvr085915, para. 133 et seq.

6. CONCLUDING OBSERVATIONS AND RECOMMENDATIONS

After years of monetary easing with ultra-low interest rates and extensive QE programmes, central banks around the world are facing the return of inflation and inflationary expectations. As economies recover from the COVID-19 pandemic, the return of this "familiar foe" can be explained by a number of factors: increased demand, labor market shortages, disruptions and bottlenecks in global supply chains, shifts in in commodity and energy production and prices – also potentially "green inflation". Whether current inflation is temporary (transient) or more permanent is nonetheless affecting wage expectations and negotiations, and is becoming a key issue of debate in academic and policy circles. The risks of choking the economic recovery complicate the normalisation of monetary policy at a time when uncertainties persist regarding the further course of the pandemic. These complex challenges require adequate central bank communication with the legislators, the public and financial market participants.

CB communication ought to be designed in a way that ensures an effective and accountable monetary policy, providing clarity and transparency as regards the considerations that inform monetary policy decisions and the interaction between the primary mandate and the secondary mandate.

Drawing on the comparative experience mentioned above, in particular the "financial instability escape clauses" used by the Bank of England, the ECB can benefit from establishing a form of communication tailored to its mandate and objectives that would similarly disclose financial stability concerns and other relevant criteria within its decision-making process.

When drafting a **communication strategy** or assessing various communication tools, the following aspects should be made transparent:

- Considerations besides price stability have to be named explicitly. It has to be made transparent and clearly explained to what extent they are considered and how it is ensured that such considerations are not trumping the ECB's primary objective of price stability.
- Although sovereign debt ratios and borrowing needs of the Member States have a significant effect on the monetary transmission, economic growth and price stability, the ECB must ensure that its monetary policy measures do not amount to monetary financing and that exit strategies are put in place to safeguard its price stability mandate from fiscal dominance.
- Financial considerations have to be taken into account as a precondition for price stability. As long as price stability is not impaired, the ECB also has a duty to contribute to financial stability. However, the decision making process must ensure that financial stability considerations do not override the goal of price stability.
- The ECB has to ensure that the effects of monetary policy measures on economic and fiscal policy are of such a nature in quality and quantity, that a monetary policy measure does not become a fiscal policy measure for which the ECB does not have competence.

The ECB should consider revamping its **specialised subcommittee for communication, the Eurosystem/ESCB Communications Committee (ECCO), or creating a special task-force** to enhance the understanding of monetary policy[102]. **ECCO** assists the ECB in external and intra-system

[102] Digitalisation offers an opportunity to improve communication through broader consultation with the public and key stakeholders. In this regard, the ECB should be commended for the initiative by the Governing Council in July 2021 to establish a high-level task force for a digital euro project https://www.ecb.europa.eu/press/pr/date/2021/html/ecb.pr210714~d99198ea23.en.html with the announcement

communication policy, particularly on issues related to multilingual publications. An interesting example of good practice is provided by the establishment in the US of a new FOMC Communications Subcommittee first chaired by Janet Yellen[103], acknowledging the need post GCF to increase the effectiveness of monetary policy by enhancing central bank transparency.

Though the ECCO has been charged with educational tasks such as surveying the relationship between NCBs and the education system in their respective Member States[104], there is little publicly available information concerning its tasks and objectives. This is not in line with the essential role of communication, which is far more than an ancillary task of a CB, but a way of increasing the effectiveness of monetary policy by enabling households and businesses to make better-informed decisions.

A revamped specialised subcommittee (ECCO) can be used both to assess and understand the existing communication channels with the various audiences and to reinforce the confidence in the transparency and integrity of the monetary policy process through a two-way communication with the public.

Vesting communication with a specialised body – such as the FOMC Communications subcommittee or a revamped ECCO – or establishing a special task force on communication, pays tribute to the important role communication has and the attention it deserves. This requires expert knowledge to be able to send the "right information" to the different counterparts, in the right format, using the right language, in the right intensity, tone and frequency in order to enable the public and financial market participants to make better-informed decisions and to improve accountability.

of the members of the Digital Euro Market Advisory Group in October 2021. https://www.ecb.europa.eu/press/pr/date/2021/html/ecb.pr211025~08af93ada7.en.html

103 Yellen (2013). See https://www.federalreserve.gov/monetarypolicy/files/fomc_extcommunicationparticipants.pdf for its remit.

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This paper examines the importance of communication of monetary policy in the light of the complex challenges central banks face post GFC in their role as 'crisis managers', confronting financial stability concerns, the economic consequences of the COVID pandemic and the risks arising from climate change and unsustainable activities. Effective central bank communication becomes ever more critical in order to preserve credibility and legitimacy. Such communication is an important component of accountability. This paper does not deal with the supervisory function of the ECB; the focus is the monetary policy of the ECB.

This paper was provided by the Policy Department for Economic, Scientific and Quality of Life Policiesat the request of the committee on Economic and Monetary Affairs (ECON) ahead of the Monetary Dialogue with the ECB President on 7 February 2022.

PE 703.339
IP/A/ECON/2022-11

PDF ISBN 978-92-846-8904-0 | doi:10.2861/ 380303 | QA- 07-22-016-EN-N