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TRANSPARENCY AND GOVERNANCE: More transparency would help the ECB weather current turmoil, says new CEPR Report

The latest *Monitoring the European Central Bank* Report from CEPR calls for two simple reforms to improve the transparency of the ECB:

- The ECB should publish the voting records of the Governing Council (though not the votes of individual members)
- The ECB should publish its anticipated interest rate path. This would be much more effective in shaping market expectations than the current approach involving the use of “code words”.

The Report, written by **Petra Geraats**, **Francesco Giavazzi** and **Charles Wyplosz**, argues that the ECB has a serious credibility and communication problem: the way the Governing Council makes its interest rate decisions remains clouded. If these decisions were made in a more transparent way, the Report argues, markets would have correctly anticipated in late 2005 that the ECB was aiming at a policy tightening of 200 basis points within two years. Such expectations would themselves have made monetary conditions less expansionary, so euro area inflation would have been lower, even with the same path of interest rate decisions.

With the policy rate now close to ‘neutral’ and global financial markets in turmoil, there is great uncertainty about the ECB’s next policy move. Now more than ever, it is important for the markets – and the public – to understand the reasoning behind the ECB’s policy decisions, the Report says.

Greater transparency would have another important benefit for the ECB, according to the Report: The only defence for central bank independence in a democracy is popular support. Support can be eroded by determined politicians, as evidenced by the declining trust in the ECB among French citizens. Such a development may tempt more politicians to earn popular support by criticizing the ECB, and the repetition of largely misguided attacks may succeed in denting the reputation of the central bank. It should not be so. The solution is better communication, and not just toward financial markets. Better communication, in turn, must rest on a clear strategy and a higher degree of transparency.

The Report argues that the ECB needs to become more transparent, and the simplest way to achieve this is to publish the voting records of the Governing Council. The voting patterns in other central banks reveal that decisions are rarely unanimous, so voting records are generally informative. Publishing the balance of votes would lead to a better understanding of how the Governing Council responds to economic information. The Report cautions against revealing the votes of individual members: this would be dangerous, since monetary policy votes could subject central bank governors to national political pressures.

The ECB would also find it easier to control inflation by doing more to shape market expectations. Helping markets anticipate the next decision is not enough, because markets care much more about the entire future course of action. The Report argues that the simplest and best way to shape expectations would be for the ECB to publish its anticipated interest rate path. This would be much more effective than the current approach involving the use of code words. The downside of code words is that they may be misinterpreted and that their very imprecision reduces the effectiveness of monetary policy.

ENDS

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