The European Central Bank Can't Master Communication

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FRANKFURT -- A successful central bank has two hallmarks: It moves interest rates at the right time. And it looks like it knows what it's doing.

The young European Central Bank earns high marks on the first point, but it's having trouble on the second.

Defying doubters, the ECB has successfully created a new currency shared by 11 sovereign nations, without any significant disruptions to financial markets or the European economy. But it isn't yet meeting the standard that its president, Wim Duisenberg, has set: to be "predictable," so markets "expect correctly what we will be doing."

Its clumsiness in signaling its intentions, in explaining its actions and in describing the role that exchange rates play in its deliberations has contributed to interest-rate volatility in Europe, and has hampered the ECB's attempts to establish credibility.

Even Mr. Duisenberg concedes in an interview that one reason for the 21% drop in the value of the euro against the dollar since January 1999 is "uncertainty in expectations" about what the ECB will do next.

'Somewhat Arbitrary'
Tuesday, picking up slightly Wednesday.

The bank's critics are getting increasingly frustrated. "You can't tell if or when the ECB is worrying about the economy or about the euro-dollar rate. Official justifications of interest-rate moves have come across as somewhat arbitrary," says the chairman of the German government's Council of Economic Advisers, Juergen Donges.

ECB officials, while acknowledging that they have been trying to improve their "communications strategy," say they deserve praise for creating the most open central bank on the globe. The critics aren't always consistent, they add. "The ECB is talking too little for some and talking too much for others," ECB economist Bernhard Winkler wrote recently in a paper delivered at an ECB conference.

**Greenspan Envy**

A big stumbling block is that top ECB officials suffer from acute Alan Greenspan envy, and often seem to come up short when compared with the Fed chairman. Mr. Greenspan is famously ambiguous; the ECB officials are often blunt. Yet the ECB is accused of not being "transparent." Mr. Greenspan rarely gives on-the-record interviews; the Europeans hold news conferences. However, the ECB is said to be less "open" because it doesn't publish minutes of meetings or disclose how policy makers vote. The Fed has no public-strategy statement; the ECB has a written one. Yet instead of praise, the ECB gets hectored for the vagueness of its written statement.

Some of the ECB's problems are of its own making. It isn't always clear when ECB officials are sending signals, and when they are simply inarticulate.

This past February offers a case study. At a news conference immediately after raising interest rates on Feb. 3, Mr. Duisenberg laid the groundwork for further rate increases. Then, on Feb. 10, the ECB fueled expectations of an imminent rate increase with talk of "upside risks to price stability" in its closely scrutinized Monthly Bulletin.

**Flip-Flop**

A week later, Otmar Issing, who built his reputation at the German Bundesbank and is now chief economist on the six-member ECB executive board, told the Financial Times that forecasts "show a substantially higher increase in the inflation rate," and stressed the need for acting in a "timely manner." Market analysts advised clients and traders that the ECB was likely to raise interest rates at its March
2 meeting. The euro rose.

But on Feb. 24 -- while Mr. Issing was on vacation -- Christian Noyer, the ECB's vice president, reversed expectations. In an interview with this newspaper, Mr. Noyer, a soft-spoken Frenchmen rarely seen without a Hermes tie, said financial markets had been reading too much into the words of the Monthly Bulletin and some of his colleagues. The markets concluded that a March 2 rate increase wasn't likely. The euro fell to its lowest level at the time.

As it turned out, the ECB didn't raise interest rates March 2. But it did so two weeks later. Mr. Duisenberg explained later that one reason for waiting was to avoid appearing to overreact to the euro's weakness. He didn't mention that the euro's plunge was triggered by Mr. Noyer's comments.

It still isn't clear whether Mr. Noyer was trying to send a signal, or whether there was disagreement inside the ECB. Questioned recently about the episode, Mr. Noyer says he was giving "exactly the same message we have tried to convey many times."

Mr. Duisenberg and Mr. Issing say they didn't confer with Mr. Noyer before the interview. "There was no need to have a discussion, because we never disagreed on this issue," Mr. Issing says. Mr. Duisenberg says the market's response to Mr. Noyer's words is incomprehensible. "I still don't understand ... why it was understood that Noyer tried to play down expectations" of a rate increase, he says.

Nonetheless, he says the incident is "a lesson that we should be even more careful in choosing our words."

To prevent confusion, the ECB's policy-making Governing Council attempts to speak with a single voice. But that's a challenge for 17 individuals -- the six members of the Executive Board in Frankfurt, plus the heads of 11 national central banks who travel from their respective capitals to Frankfurt once every two weeks.

**Changing Fashion**

In the old days, central banks didn't prepare financial markets for their next moves. They believed they were most effective when they surprised the markets. Until 1994, the Federal Reserve didn't even disclose when it moved short-term interest rates.

That's no longer fashionable. Central bankers now believe that economies function better when markets understand central-bank
thinking so well that when economic circumstances change, markets move rates even before the central bank acts. But to some ECB officials, the need to prepare markets for rate moves is still novel, says Alfons Verplaetse, recently retired head of the Belgian central bank. "We weren't accustomed to that."

The ECB's difficulties are compounded by the challenge of delivering a single message to a multicultural, multilingual audience. That leads to unavoidable confusion, Mr. Duisenberg says. The Fed, the Bank of England and the Bundesbank work in one language. The ECB copes with 11 and works in one, English, which is a second language for almost all its staff and top officials.

**Gods and Mortals**

From the ECB's offices overlooking the River Main, it often seems that the markets and the press treat Alan Greenspan as a god, and Wim Duisenberg as a mere mortal. Mr. Duisenberg, a chain smoker with a shock of white hair and a tired face, feeds that perception with a knack for sometimes saying more than he means to, or confusing rather than clarifying.

In April 1999, for instance, during several hours of questioning before the European Parliament, Mr. Duisenberg said a lot about the euro. But one thing stuck: "Not having an exchange-rate policy, and we have no policy, does not mean that there is benign or malign neglect. For the time being, there is neglect."

Whatever he meant, markets concluded that the ECB's hands-off attitude toward the currency made euro-denominated assets risky.

The timing was bad. Tommaso Padoa-Schioppa, the ECB board member in charge of international matters, was heading to Washington for a spring meeting of global finance ministers and central bankers, and he had to explain what Mr. Duisenberg meant. "I can't believe he said that," Mr. Padoa-Schioppa told a now-retired European central-bank official, the official says. (Mr. Padoa-Schioppa says he doesn't recall saying that, and adds that, in context, Mr. Duisenberg's statement didn't "proclaim a general attitude of indifference vis-a-vis exchange rate developments of the euro.")

**Undoing the Damage**

National central-bank chiefs groused privately. Eight days later, Mr. Duisenberg tried to undo the damage, telling a Washington audience: "We don't neglect" the euro exchange rate.

ECB officials boast that Mr. Duisenberg's monthly news conferences prove that the ECB is more forthright than the Fed -- though those
news conferences also offer Mr. Duisenberg a monthly opportunity for verbal miscues. On at least one occasion, the ECB staff has altered Mr. Duisenberg's words before posting a news-conference transcript on its Web site: On Feb. 3, Mr. Duisenberg described a rate increase as a "warning" to unions to keep wage demands moderate. The ECB's top spokesman, Manfred Koerber, softened the word to "signal."

Mr. Duisenberg begins each news conference by reading a prepared statement, which, according to him, is drafted by policy makers in Frankfurt and then "extensively discussed and changed and amended" by the broader council. Although the full ECB council usually doesn't prepare Mr. Duisenberg for fielding reporters' questions, the president does bounce possible answers off a couple of colleagues beforehand.

By the time Mr. Duisenberg is fielding questions, markets already know whether the ECB has moved rates. The Q&A is where markets try to discern where the ECB is headed. But it's sometimes hard to tell whether the ECB is or isn't trying to provide that information.

**Biased Answer**

Last July, three months after the ECB had cut rates amid fears of deflation and recession, Mr. Duisenberg gave an upbeat assessment of the economy. One reporter asked whether the ECB statement meant that it has a bias toward higher interest rates. Mr. Duisenberg's answer: "You could interpret that, not as a bias, but as a bias gradually creeping into our considerations."

That answer -- not the text of the ECB communique -- was the lead on many stories about the news conference. Today, Mr. Duisenberg says he anticipated the question and did discuss it with colleagues in advance. But it was four months -- too long, Mr. Duisenberg says with the benefit of hindsight -- before the ECB actually raised interest rates for the first time ever.

Further efforts to clarify himself didn't help much. In September, Mr. Duisenberg pointed out that he hadn't used the word "bias" in the July news conference, but, rather, that a reporter had. Then he added: "It's creeping and it remains creeping -- but at a snail's pace." That last phrase was spontaneous, he says, noting that some of his colleagues had to consult their dictionaries to understand it.

Today, Mr. Duisenberg says there was a reason for all this. "Once you introduce a bias explicitly, you always have to do it, and it may be something you wouldn't always want to do," he says. "I don't regret having answered the way I did, and I don't regret that I tried to get away from it in the future."

**Little Training**
This attention to his every utterance isn't something for which his 15 years as governor of the Dutch central bank prepared him. Financial markets didn't hang on his every word then.

On this score, central bankers from bigger European countries have had more experience. Jean-Claude Trichet, governor of the Bank of France and Mr. Duisenberg's likely successor at the ECB, has been fencing with the press for years. Before each interview, Mr. Trichet writes down the points he wants to make. "On very delicate and touchy matters, you are better off in being extremely cautious and sticking to carefully drafted terms of reference," he says.

Lately, ECB officials have adopted the approach of Robert Rubin, the former U.S. Treasury secretary: find a mantra and repeat it. Since January, ECB officials have been repeating that "a strong euro goes with a strong economy."

It worked better for Mr. Rubin than it has for the ECB so far. Also, some ECB officials clearly don't like speaking in soundbites. "We all had to develop into parrots," Mr. Issing says. "I still feel somewhat uncomfortable in behaving that way, because I think you could give a lot of reasonable explanations and contribute better."

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