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Globalization of capital markets has received new momentum and it will continue to be of major importance in the years to come. The increasing integration of financial markets and the rise of foreign direct investment is partly a consequence of world trade expansion, but in addition to this underlying trend the worldwide collapse of socialist systems and the opening up of big economies like India and China have fuelled the development of globalized capital markets. This book takes stock of recent developments with emphasis on emerging capital markets.

There were lessons to be learned from the past, in particular that a global financial system, although it is efficient due to its size and diversity, is a vulnerable institution. The experience was that financial crises occur unexpectedly and their strong contagion effects spread worldwide. From this experience the question of what makes a financial system sound receives a prominent role on the research agenda of economists. Also, the question arises as to how the role of monetary policy should be defined under a changing global financial architecture. Evidently, a regime of flexible exchange rates between the major currencies does not provide for autonomy in pursuing domestic monetary policy strategies. The interdependence of monetary policy requires its contribution in securing financial security. These issues are addressed in this volume.

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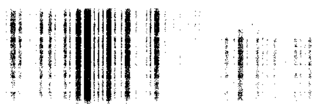
The Anglo-German Foundation for the Study of Industrial Society aims to contribute to the knowledge and understanding of industrial society in the two countries and to promote contacts between them. It funds selected research projects and conferences in the industrial, economic and social policy areas designed to be of practical use to policy-makers.

Printed in Great Britain

palgrave macmillan

GLOBALIZATION OF CAPITAL MARKETS AND MONETARY POLICY

Edited by Jens Hölscher and Horst Tomann



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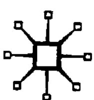

Selection and editorial matter © Jens Hölscher and Horst Tomann 2005
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First published in 2005 by
PALGRAVE MACMILLAN
Houndmills, Basingstoke, Hampshire RG21 6XS and
175 Fifth Avenue, New York, N.Y. 10010
Companies and representatives throughout the world.

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ISBN-13: 978–1–4039–4347–7
ISBN-10: 1–4039–4347–8

This book is printed on paper suitable for recycling and made from fully managed and sustained forest sources.

A catalogue record for this book is available from the British Library.

Library of Congress Cataloging-in-Publication Data
Globalization of capital markets and monetary policy / edited by Jens Hölscher and Horst Tomann.
p. cm.—(Anglo-German Foundation)
Based on papers of a conference held at Freie Universität Berlin in March 2004.
Includes bibliographical references and index.
ISBN 1–4039–4347–8
1. International finance – Congresses. 2. Capital market – Congresses. 3. Economic stabilization – Congresses. 4. Monetary policy – Congresses. I. Hölscher, Jens. II. Tomann, Horst. III. Anglo-German Foundation series
HG3881.G5769 2005
332'.0424—dc22 2005042829

10 9 8 7 6 5 4 3 2 1
14 13 12 11 10 09 08 07 06 05

Printed and bound in Great Britain by
Antony Rowe Ltd, Chippenham and Eastbourne

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8 Central Bank Transparency: Reasons for 'Creative Ambiguity'

Elke Muchlinski[1]

Introduction

Research on transparency and language aspects of central banks has flourished over the past years. This chapter examines reasons why central banks have chosen to become more transparent in explaining the value of transparency in conducting monetary policy. Modern central bank theory has been passing beyond the silent black box mechanism. For instance, the Fed has been walking a long way from 'monetary mystique and secrecy' (Goodfriend, 1986). This is also true for academic discourses on central bank statements, which have initiated a theoretical upheaval over the last few years. Transparency of independent central banks is desirable for the enhancement of the effectiveness and accountability of central banking. At this point, the focus on language has been drawing much attention. Undoubtedly, the central bank guides the expectations of economic agents, and it is also part of its own backdrop because talk and the policy of disclosing certain information are to be interpreted as self-commitments of a central bank. More precisely, the central bank aims to share these expectations because of its interest in achieving its objectives. As new research emphasizes, central bank statements convey useful information *if* market participants *perceive* what a central bank is really saying, i.e. interpretation matters. This has caused the scientific community to become wary of traditional concepts of interaction between institutions. The new paradigm, as Blinder (1998) expresses it, is '*matching deeds to words*'. How, when and in which ways do statements by a central bank have a function in shaping the expectations of private agents? Current studies shed light on the difficulties of answering these questions. As the use and meaning of words cannot be separated from context, the development of a 'lingua franca' or 'language code' of a central bank is not desirable. My chapter explores thought-provoking arguments on the way central banks talk.

In section 1 of my chapter, I therefore try to explain why the meaning of transparency is not in conflict with 'creative ambiguity' is not in conflict with 'creative ambiguity'. Section 2 outlines reasons for 'creative ambiguity'. Section 3 examines a number of aspects that could be grouped under the heading 'is there a special language needed for central banks?'. It focuses on current contributions to central bank talk and how economic theory could deal with it. Section 4 deals with the demand of a special language for central bank talk. Section 5 shows why central bank talk matter referring to empirical research. Section 6 explains the constitutive and social aspects of language within market interactions. This is followed by concluding remarks in section 7.

Two sides of one coin: the meaning of transparency and 'creative ambiguity'

> With due apologies to Einstein, a central bank's long-run objectives should always be spelled out as clearly as possible, but not more so ... Einstein allegedly said, 'everything should be made as simple as possible, but not more so'.[2]

There is a growing consensus of opinion in the literature concerning central bank transparency and communication:

> Attitudes and policies toward central bank communications have undergone a radical transformation in recent years. Not long ago, secrecy was the byword in central banking circles. Now the unmistakable trend is towards greater openness and transparency. Increasingly, central banks of the world are trying to make themselves understood, rather than leaving their thinking shrouded in mystery.[3]

Poole also states, 'how, not whether'.[4] Central banks need to talk about their objectives and methods, i.e. forecasts, models, tactics and decisions.[5] The question of how a central bank should talk is still in debate. As Blinder *et al.*, state, in principle, central banks should be transparent about their decisions and proceedings of monetary policy meetings as well as about their own view of future developments.[6] Therefore transparency focuses not simply on providing more or maximizing information, for instance, monthly reports, minutes, speeches and press releases, etc., but requires a certain way of conveying information to market participants. Poole writes:

> It is hardly surprising that central bankers are more talkative than they were just a decade or so ago, and more concerned about how to improve transparency and communication with the market. Perhaps only one issue is settled: Transparency is important but is hard to accomplish because miscommunication is so easy. Clearly, more talk does not necessarily mean greater transparency.[7]

Moreover, more information does not imply greater transparency. First of all, this view implies that a central bank does not try to fool the public. As Cukierman shows, 'the credibility problem of monetary policy is a thing of the past'.[8] From the viewpoint of the Bank of England, Vickers outlines:

> It should go without saying that the MPC's objectives are given by the Act and by the remit set by the Chancellor. There is a large literature on inflation bias, but it is simply not applicable to the MPC. We have no desire to spring inflation surprises to try to bump output above its natural rate (wherever that may be). Quite apart from the obligation to fulfil our statutory duty, we have the strongest professional and reputation incentives, which in my opinion are incapable of being enhanced by financial incentives, to get as close as we can to the inflation target.[9]

Therefore, the theoretical assumptions of the KPBG[10] model do not make any sense. There seems to be no dispute about that issue between central banks themselves:

> If the monetary authority can be clearer about what it is doing now and plans to do – not in the sense of setting future moves in stone, but rather in terms of explaining risks that might influence future policy – then market participants can improve their expectations of future short rates, and possibly reduce the premium for uncertainty.[11]

Disputes in theoretical debates have not been reaching the realm of central bank practice, which focuses on the effectiveness of monetary policy as practice and tries to avoid assumptions that are not linked to the contemporary world.

An admitted fact is the asymmetry of time horizons of the different agents in different markets and the central bank. The goal of price stability is a long-lasting objective a central bank can only try to achieve by acting in short time horizons, which may conflict with the interests of market participants. Cukierman makes his objection:

> The quadratic objective function originally postulated by KPBG carries the rather unintuitive implication that, given inflation, an upward deviation of employment from its desired level is as costly as a downward deviation of the same size. It is hard to see, why policymakers, or social planners for that matter, would object, given inflation, to a positive output gap. As a matter of fact it's quite likely that, in the range of positive output gaps, the quadratic was postulated mainly for analytical convenience rather than for its descriptive realism.[12]

Transparency is not an option, rather, a requirement of modern central banks. There is no 'invisible hand' which co-ordinates the central banks' decisions on interest rates with the result of an international equilibrium. As Keynes puts it:

> In the modern world of paper currency and bank credit there is no escape from a 'managed' currency, whether we wish it or not; convertibility into gold will not alter the fact that the value of gold itself depends on the policy of the Central Banks. It would have been absurd to regulate the bank rate by reference to a 'proportion' which had lost all it significance ... The bank rate is now employed, however incompletely and experimentally, to regulate the expansion and deflation of credit in the interests of business stability and the steadiness of prices.[13]

A central bank must be able to act flexibly, which does not imply acting without self-committing. Transparency implies an understanding of what a central bank is, in fact, doing. Self-commitment is therefore linked to transparency, independence and accountability. Transparency is a result of verbal and non-verbal interactions and of reciprocal relationships between a central bank and the market about changes of market variables and the perceived reaction by the central bank, the market and the public.

There is no conflict between transparency and secrecy per se, as some authors to the current debate state. From the viewpoint of effectiveness and democratic accountability, economic preferences are lexicographic.[14] What matters is neither the so-called 'right' anticipation of a monetary policy decision nor simply the adaptations of prices in the markets as modelled in the traditional world of stimulus-reaction models. Furthermore, the effectiveness of monetary policy is neither a result of such stimulus-reaction models nor of the Sargent-Wallace world in which the 'policy-ineffectiveness proposition' combined with the neutrality of money hypothesis dominate all thinking and reasoning and which is represented by the common knowledge assumption itself. In such an artificial world interaction is not needed; moreover, talk, language and communication are meaningless.

Contrary to this model world, transparency refers to understanding and verbal and non-verbal interactions. Regarding the importance of talk, language and communication to monetary policy, the Fed has been pursuing a new strategy of communication since 2000; and already, since 1994, the Fed has been announcing the target for the FFR.

> The language indicates the Committee's sense of the balance of risks in the outlook against the background of the Committee's long-run goals of price stability and sustainable economic growth. Specifically, it indicates whether the Committee believes that the risks are 'balanced with respect to prospects for both goals', 'weighted mainly toward conditions that

> may generate heightened inflation pressures', or 'weighted mainly toward conditions that may generate economic weakness'.[15]

The Fed signals its verbal participation within a social context and reflects the reciprocal relationship with the market, which has to be interpreted. These are the bases for its reputation and credibility. Goodfriend explaines the Fed's inclination to 'monetary mystique: secrecy' in the late 1970s:

> The FOMC argues that the Directive is written in 'terms of art' that are vague and cannot always be accurately interpreted. But this problem could be dealt with by making the language of the Directive more explicit and intelligible ... The FOMC argues that because it has no experience predicting market response with disclosure of the current Directive, policymaking with disclosure would be difficult.[16]

Reasons for 'creative ambiguity'

According to current literature, as Blinder *et al.*, emphasize, there are, of course, certain reasons for 'creative ambiguity' (2001: 2). Under certain circumstances 'creative ambiguity' could be seen as an elementary strategy for a central bank in dealing with the challenges facing monetary policy. First of all, achieving transparency cannot be measured as an optimum of available information (Issing, 1999: 508). Transparency can only be judged as a 'degree of transparency'. Therefore secrecy is still required concerning special issues of central banking, for instance 'the protection of proprietary information', which, of course, is not the norm (Blinder *et al.*, 2001). A further reason(s) for 'creative ambiguity' concerns intervention in foreign exchange markets. Blinder *et al.*, emphasize differentiating between markets and the public, i.e. between different time horizons and therefore the phenomenon of time asymmetry. Every decision and action of the central bank has to be discussed within this time asymmetry. The reason is that markets act within a short-term horizon, more or less a few month hence, whereas public attention is attracted to the result of monetary policy, i.e. price stability after several quarters or a few years. Real rates, e.g. real wages, real interest rates, are results of market processes over time(s). Any change of the Federal Funds Rate will change other economic variables with a longer-lasting horizon than the market normally focuses on. The monetary transmission channel is driven by expectations, therefore the focus of any central bank's transparency and accountability must be concentrated on this expectations-building process in order to influence its long-lasting horizon of price stability. So the reasons for 'creative ambiguity' concern the communication strategy of a central bank, as in the case of the Fed, for instance, which has been navigating a difficult transition to achieve and maintain credibility for price stability since the late 1970s.

Transparency implies: 'we do what we say' and 'say what we do', whereas accountability means 'we do what we are supposed to do'.[17] This is also due to a modern view of central banking. As Blinder points out:

> A central bank is invested with enormous power over the economy; and, if it is independent, that power is virtually unchecked. This authority is a public trust assigned to the bank by the body politic. In return, the citizenry has a right to expect – no, to demand – that the bank's actions match its words. To me, that is the hallmark of credibility: *matching deeds to words*.[18]

Issing outlines *another important point*:

> complete transparency of the underlying information set, as well as the thinking and ulterior motives behind central bankers' decision, is logically and practically impossible to achieve ... This reflects a deeper (philosophical) recognition of the limits of 'knowledge' and the impossibility of providing and communicating anything like a full description of reality: 'Reality is never transparent. What we see from any one angle is always only part of the picture.'[19]

Central bank talk: is a special language needed?

Do central banks need a special language to communicate with market participants? Karen Johnson, Board of Governors of the Federal Reserve System, argues central banks need first of all to create a 'communication language. Currently, they tend to use very few words, often seen as coded language.' She discusses the problems of using a coded language because, 'when these words seem to work with the target audience they are used over and again. But then, if the words differ only a little bit from one time to another, they may be mistakenly interpreted as a policy change.'[20] The risks of such a coded language are evident because any formal language that is not rooted in practice and social interaction will become artificial and therefore meaningless regarding the monetary policy strategy and interaction with market agents. Language matters as *sens practique*, but not as 'scholasticism'.[21] According to modern view of language theory, language is not only a vehicle of thoughts.[22] Words and language are not *quantités négligeables* (Aristotle) as some of the ancient philosophers had stated. Language is not a neutral thing. As Wittgenstein emphasizes:

> When we talk about language (words, sentences, etc.) I must speak the language of every day ... You say: the point isn't the word, but its meaning, and you think of the meaning as a thing of the same kind as the word, though also different from the word. Here the word, there the meaning. The money, and the cow that you can buy with it. (But contrast: money, and its use).[23]

The meaning of words manifests itself in practice.

At this point it is worth mentioning that in modern theory of central banking the views of economists from earlier eras, for instance John St Mill, are no longer accepted. In section 3 of his article 'Of Money' – 'Money is a mere contrivance for facilitating exchanges, which does not affect the laws of value' – Mill (1848, p. 505) stated, on the neutrality of money:

> There cannot, in short, be instrinsically a more insignificant thing, in the economy of society, than money; except in the character of a contrivance for sparing time and labour. It is a 'machine' for doing quickly and commodiously, what would be done, though less quickly and commodiously, without it.[24]

Why does central bank talk matter?

Kohn and Sachs (2003) investigate *how* and *if* statements by the Federal Open Market Committee (FOMC), as well as testimonies and speeches by the Chairman, Alan Greenspan, are able to move economic variables significantly.[25] Their hypothesis claims that only empirical investigation could provide an answer to the question of *how* and *if* these central banks' talk matters. According to a contribution by Chuck Freedman (1996, 2002)[26] the authors differentiate three types of communication: (1) the FOMC statements (so called 'risk bias' or 'balance of risk assessment') which are released to the public immediately after the meeting of the FOMC, (2) the testimony by Chairman Greenspan and (3) the speeches by the Chairman. They then try to measure the effects of these three types of communication on the transparency of the Fed and the public's understanding.[27]

The underlying questions are: is there a link between the 'new language' strategy the FOMC started in January 2000 and the effectiveness of monetary policy? Are there significant effects on the movements of the short-term or long-term interest rates? Have these three types of communication been improving the transparency of the Fed? Is there any remarkable effect to be mentioned regarding the aim of the Fed sharing the expectations of market participants? Does central bank talk matter at all? The economic variables, particularly the Treasury forward rate and interest rates are driven more by words than by deeds. 'In this regard, statements appear to be an important component of the policy implemented by the FOMC.'[28]

The testimonies of the Chairman to the Congress have a still greater effect on the economic variables in question, i.e. 'federal funds rate, Eurodollar future rates, the two-year Treasury yield, and Treasury forward rates' (Kohn and Sachs, 2003: 12). They argue that the FOMC statements often contain the same information but its disclosure does not lead to such a significant effect on the near-term interest rates as the Chairman's testimonies do.

So what actually is the difference between these two types of communication? Let us first move on to the third type of communication. Compared to the FOMC statements and the testimonies of the Chairman, the third type of communication, the speeches of the Chairman, evidently do not have a remarkable effect on the movements of economic variables at all. The reasons are presumably to be found in the broad range of topics, which are regularly discussed by Greenspan. The speeches of Greenspan deal with many issues, including those which are not concerned in a narrow sense with monetary policy strategy. Nevertheless it is reasonable to suppose that the effects of these speeches are embedded in the Fed's function of providing a pattern of prospective roots of monetary policy strategy – a prospective view, which is important to the expectations of market participants.

Although the authors deny a systematic link between the speeches of Greenspan and the reactions of market variables, i.e. changes in the decisions and reactions of market participants resulting from his speeches they do not argue that the speeches are without any relevance. The empirical evidence shows that they are less significant to the market variables compared with the two other types of communication. Kohn and Sachs also state: 'Judging from the effects of his testimonies, we believe that speeches that address the current or prospective economic environment are likely to generate a significant market response' (2003: 12). So, central bank talk matters regarding these three types of communication – but why does this talk matter? Kohn and Sachs emphasize the important role of expectations for economic development. A central bank cannot be successful in avoiding or fooling market agents or market expectations [29] The reason is obvious, as Blinder puts it: 'In other words, the interest rate that the central bank can control doesn't matter (much), and the rates that really matter cannot be controlled' (Blinder, 1998: 30). The long-term interest rate plays a significant role for investors and the expectations of 'prospective yields' (Keynes, 1936). Long-term interest rates indicate, therefore, risk and uncertainty in the market. A high-risk premium corresponds to high perceived uncertainty as well as to a 'negative state of confidence' (*ibid.*). Without doubt, the market's interest in listening to the view of the Chairman is evidently given. A lack of transparency would impede the effectiveness of monetary policy and also restrict its ability to fight monetary shocks.

Let us turn now to another contribution: Winkler also defines transparency as linked to a communication strategy of a central bank and common understanding.[30] He proposes a differentiated view of transparency focusing on 'the twin roles of a monetary policy strategy: information efficiency and communication'. Transparency in his view is composed by clarity, honesty and common understanding.[31] He defines the meaning of monetary policy strategy in a broader sense 'as a systematic framework for organizing and structuring information and analysis rather than a specific monetary policy reaction function prescribing direct "mechanical links" of

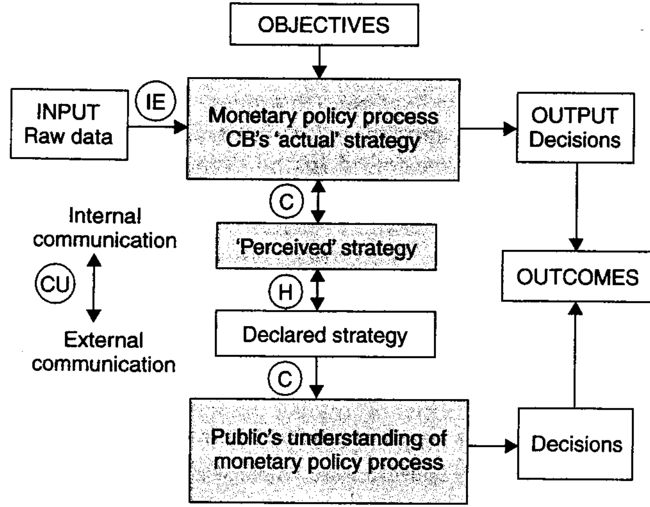

Figure 8.1 Monetary policy strategy and communication
Source: Winkler (2000): 23

policy decisions to particular economic variables' (Winkler, 2000: 15). This definition implies the demand for a central bank to 'aim at information efficiency'. A central bank needs to 'provide a framework for communication (i.e. a vehicle for information transmission) both externally – in explaining monetary policy to the public – and internally (at least in the case of decision-making by a committee, but also in interaction between staff and policy-makers' (*ibid.*). Winkler's proposal of monetary policy strategy and communication is pictured in Figure 8.1.

Winkler proposes two dimensions of central bank communication: internal and external communication. Both dimensions are important for achieving transparency. Furthermore, the process of communication is to be differentiated in a vertical and horizontal dimension, as seen in the grey and white boxes. These coloured figures give a first impression of the problems any central bank has to deal with: the perception and attention that market participants do or do not pay to its statements or information.

The fundamental assumptions of this new approach to central bank communication by Winkler are clarity (C), honesty (H) and common understanding (CU).[32] Given also the assumption of 'bounded rationality' (Simon), clarity is beyond an optimum of using available information. Clarity implies the strategy by central banks to structure and simplify information. Regarding heterogeneous agents in the market, a central bank has to differentiate its information, which can no longer be viewed as a homogeneous good. The danger of confusion from multiple public messages or greater asymmetry of information forced it to provide differentiated information.[33]

The result is that the traditional assumption of common knowledge is meaningless because different agents or groups in the market will get different information, which they also perceive and interpret differently.[34]

How then, is understanding possible? 'Without this sharing of reactions to common stimuli, thought and speech would have no particular content – that is no content at all.'[35] Understanding depends on how market participants do interact – verbal and non-verbal.

> To understand the speech of another, I must be able to think of the same things she does; I must share her world. I don't have to agree with her in all matters, but in order to disagree we must entertain the same proposition, with the same subject matter, and the same standard of truth. Communication depends, then, on each communicant having, and correctly thinking that the other has, the concept of a shared world, an intersubjective world … The conclusion of these considerations is that rationality is a social trait. Only communication has it.[36]

Honesty indicates that the meaning of a central bank statement cannot be an external one.[37] Winkler defines honesty as 'the degree to which the representation of information employed in external communication corresponds to the actual structuring of information adopted internally. … Conflicts may, however, arise between internal and external communication needs' (Winkler, 2000: 20).

Avoiding the traditional notion of common knowledge, Winkler examines the relevance of common understanding. Since monetary policy acts on the basis of rules, these rules are to be interpreted as a 'coordinating function in organizing public discourse' (*ibid.*: 23). He emphasizes the importance of the sender within his modified receiver-audience model in order to conclude: 'transparency rests on the degree of common understanding between the two and is thus a social phenomenon' (*ibid.*: 23). The reason is that central bankers' language is often vague. Vagueness is characteristic to language, which is a social phenomenon. Trying to express a central bank's or central banker's statement in formal language would avoid common understanding. As empirical evidence on central bank transparency and information policy strategy documents, the language a central bank has chosen to express or explain its monetary strategy may differ very much across countries and central banks.[38] Nevertheless their need to focus on special information and to investigate certain economic developments, i.e. the monetary transmission process which differs extremely between countries, or prices of goods markets, currencies, the rate of economic growth, etc., furthermore, to create and communicate certain data according to an economic environment describes clearly their role as a monetary institution.[39] As monetary institutions, they do have comparable monetary strategies in order to achieve the effectiveness of monetary policy. Winkler concludes: 'From this

perspective a monetary policy strategy is like a language. Like a language it provides tools, and a frame for reasoning, and a vehicle for communication' (Winkler, 2000: 23).

At this point, it should be emphasized that language is not a vehicle to transmit ready-made information by a sender to a receiver who is like an empty box, which just receives information passively. Winkler himself discusses this point around his description of Figure 8.1: the distinction between the white and grey boxes makes it clear without doubt, the antique 'conduit-metaphor' is neither compatible with modern central bank theory and practice[40] nor with the modern view of communication[41] and the function of language, respectively.[42] Consequently Winkler states:

> The notion of transparency as common understanding not only refers to information and modes of interpretation shared between central bank and the public. Communication takes place not between two monolithic players but between multiple senders ... and multiple receivers. In such a setting, a central bank's announcements also perform additional internal and external coordination functions.[43]

Let us summarize Winkler's view so far. The avoidance of the common knowledge assumption opens another theoretical perspective on the interaction of a central bank with the heterogeneous audience and different markets.

Constitutive and social aspects of language

> 'The rule-governed nature of our language permeates our life.'[44]

No central bank can achieve knowledge about the decisions and reaction of market participants ex ante. It can only indicate the perception of market participants regarding their decision-making and actions. For instance, the 'public's understanding of the monetary process' (in Figure 8.1 by Winkler) is only observable by the decisions and reactions of those individuals. Therefore a central bank has to achieve an understanding of the opinions and beliefs of market participants. Since there are no direct interactions between a central bank and the participants, it can only get to this level of knowledge by interpreting market reactions. This is also true for market participants themselves.

At this point communication seems to be the magic word of this century – or is it just a myth? Due to current literature, theories of communication are only successful as far as they are based on metaphors. The function of a metaphor is to point out the core of the dialogue by neglecting other issues. Metaphors matter by focusing on particular aspects of daily use of language, i.e. social practice. Patterns of communication emerge from routines and

evolve into pattern of decisions and actions. Patterns of communication are important for the expectation building process (for empirical results, see Kohn and Sachs, 2003). Success in understanding depends on routine. Success of communication is not to be confused with exchange of information since the impact of communication requires interpretation. The effectiveness of communication in terms of the antique 'conduit-model' implies simply a repercussion of reactions without focusing language and meaning, etc.[45] It is simply a mechanic exercise analogous to the pendulum proposed by of Isaac Newton. However, going beyond this framework of the 'conduit-metaphor', language and meaning are evidently becoming important. But how is it possible to measure the effects of communication?

As Kohn and Sachs (1993) emphasize, the perception and attention of the audience is attracted to central bank statements, speeches, etc. How do market participants acknowledge and perceive a central bank's statements, information, etc.? A very basic assumption underlying all talk – including talk by central banks – is the following:

> Nothing could be more obvious: we want to be understood and others to have an interest in understanding us; ease of communication is vastly promoted by such sharing ... It is absurd to be obligated to a language; so far as the point of language is concerned, our only *obligation*, if that is the word, is to speak in such a way as to accomplish our purpose by being understood as we expect and intend ... What matters, the point of language or speech or whatever you want to call it, is communication, getting across to someone else what you have in mind by means of words that they interpret (understand) as you want them to ... The intention to be taken to mean what one wants to be taken to mean is, it seems to me, so clearly the only aim that is common to all verbal behavior.[46]

As Blinder *et al.*, state at the beginning of their study, central banks today reflect their role as an institution that needs to clarify its role in the public and not to hide from the public.[47] A coded language or 'new language', particularly for central banks, is not required. This demand for a new language in order to create 'an own specific language and corporate culture to serve their particular internal and external coordination needs' is not desirable.[48] As I mentioned before, any such artificial language would fail since language evolves from how it is used in practice.

> What is needed is a norm, something that provides a speaker with a way of telling (not necessarily always) that he has gone wrong, a norm the failure to satisfy which he or she will count as having gone wrong ... Speaking in accord with socially accepted usage is such a norm, but one which, I have argued, is irrelevant to communication unless the audience of the speaker happens to speak as he does, in which case the norm is

irrelevant not because it is a shared practice or convention, but because conforming to it results in understanding.[49]

Why does such a norm matter? It provides a purpose for any speaker in search of understanding. Success of communication results in shared practices. The obligation, therefore, is to use words, i.e. sentences, in such a way as to accomplish the purpose by being understood as we expect. Therefore a central bank will earn credibility by 'matching deeds to words', not by creating an artificial language, which is not rooted in central bank practice itself.

How could a central bank be understood by market participants (see again Figure 8.1 and the distinction between grey and white boxes) and what could a central bank perceive from them? Are there any guidelines to understand the meaning of its talk or types of communication?

> Meaning, in the special sense in which we are interested when we talk of what an utterance literally means, gets its life from those situations in which someone intends (or assumes or expects) that his words will be understood in a certain way, and they are ... Thus, for me the concept of 'the meaning' of a word or sentence gives way to the concepts of how a speaker intends his words to be understood, and of how a hearer understands them. Where understanding matches intent we can, if we please, speak of 'the meaning'; but it is understanding that gives life to meaning, not the other way around.[50]

Conclusion

Research on transparency and language aspects of central banks has flourished over the past years. This chapter tries to explain why the meaning of transparency is not in conflict with 'creative ambiguity'. As the use and meaning of words cannot be separated from context, the development of a 'lingua franca' or 'language code' of a central bank is not desirable. My chapter explores some thought-provoking arguments on the way central banks talk. Transparency is a result of verbal and non-verbal interactions and of reciprocal relationships between a central bank and the market about changes in market variables and the perceived reaction by the central bank, market and public. The Fed signals its verbal participation within a social context and reflects the reciprocal relationship with the market, which has to be interpreted. These are the bases for its reputation and credibility. Under certain circumstances 'creative ambiguity' could be seen as an elementary strategy for a central bank to deal with the challenges facing monetary policy. Therefore, secrecy is still required concerning special issues of central banking. The risks of a coded language are evident because the effects of language are rooted in practice.

Notes

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2. Blinder *et al.* (2001): 1.
3. *Ibid.*
4. Poole (2003).
5. See: Eijffinger and Geraats (2002); B. Friedman (2002); Issing (1999); Muchlinski (2002); Posen (2003).
6. Blinder *et al.* (2001): 3–5.
7. Poole (2004).
8. A. Cukierman (2002) 'Are Contemporary Central Banks Transparent About Economic Models and Objectives and What Differences Does It Make?', *The Federal Reserve Bank of St Louis*, 15–35. http://www.stlouisfed.org/news/speeches/2002.html. An earlier version of this paper was published, see Cukierman (2001).
9. Vickers (1998).
10. KPBG – Kydland-Prescott-Barro-Gordon model.
11. Ferguson (1999): 2.
12. Cukierman (2002): 16.
13. Keynes (1924): 170 and 172.
14. See Daniel L. Thornton (2002) 'Monetary Transparency: Transparency About What?', Working Paper 2002-028B, Federal Reserve Bank of St Louis, November. http://www.research.stlouisfed.org/wp/2002/2002-o28.pdf
15. Ferguson (2001): 5.
16. Goodfriend (1986): 79–80.
17. Issing (1999): 508. See also, 'Central banks should not pretend to have magical insights' (*ibid.*: 507).
18. Blinder (1998): 63–4.
19. Issing (1999): 507. Geraats proposes to define transparency as the absence of asymmetric information, see Geraats (2002).
20. See Blinder *et al.* (2001): 96. Issing also objects to the use of coded language. See Issing (2004).
21. Gebauer (2005).
22. Trabant (2003).
23. Wittgenstein (1978): 120.
24. Mill (1848).
25. Kohn and Sachs (2003).
26. Freedman (1996, 2002).
27. There is no space and time here to discuss the implications and consequences of the investigation given by Kohn and Sachs; see Muchlinski (2004).
28. Kohn and Sachs (2003): 11. See also Ehrmann and Fratzscher (2004).
29. 'Outreach efforts such as this are important because a central bank in a democracy depends on the trust and confidence of the citizenry. To earn and maintain that trust, the Fed must communicate to people about what we do and why we do it. These displays represent one innovative example of how the Fed fulfills its responsibility to reach out and educate the public about the important mission and work of its central bank.' Greenspan (2001).

30. Winkler (2000): 15.
31. *Ibid.* Winkler definitely does not adopt a 'socio-linguistic approach' as Geraats (2002) states. For a 'socio-linguistic approach' see, for instance, the books by Coulmas and Florian (1992).
32. See Winkler (2000): 17.
33. This could also lead to a greater information asymmetry.
34. 'An event is common knowledge among a group of agents if each one knows it, if each one knows that the others know it, if each one knows that each one knows that the others know it, and so on ... Thus, common knowledge is the limit of a potentially infinite chain of reasoning about knowledge.' Geanakoplos (1992): 54.
35. Davidson (1991): 159–60.
36. Davidson (1982): 327.
37. 'If all we have to go on is the fact of honest utterance, we cannot infer the belief without knowing the meaning, and have no chance of inferring the meaning without the belief.' Davidson (1974/1984): 142.
38. Siklos (2002).
39. Amtenbrink (1999).
40. Bernanke and Kuttner (2003); Blinder *et al.* (2001); Blinder (1997,1998).
41. Krippendorf (1993).
42. Knobloch (1999); Maennel, B. (2002); Tsohatzidis (1994).
43. Winkler (2000): 24.
44. Wittgenstein (1992).
45. Due to this antique view the aspect of semantics was seen as unimportant, see Shannon and Weaver (1949/1963); see also Reddy (1979).
46. Davidson (1994): 9.
47. Amtenbrink (1999) has described the historical process of central bank's constitution.
48. See Winkler (2000): 24.
49. Davidson (1994): 11.
50. *Ibid.*

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