Non technical summary

The speech of Draghi at the Global Investment Conference in London on 26 July 2012 was history in the making. The announcement of the OMT program and the subsequent disclosure of detailed steps of its implementation in September 2012, led to a reduction of the risk premium in the euro market, thus to a reduction of the “risk of convertibility” and served to support the euro. What can be said about the context of that speech? At the time of Draghi’s speech a tremendous uncertainty determined the expectations of the investors. There were several factors contributing to the uncertainty, for example negative experiences with the SMP program of the ECB in 2010. Grave doubts about the functioning and acceptability of the European Stability Mechanism (ESM) can be seen as a factor. Massive capital flows from debtor countries to credit countries within the Eurozone in 2011 and 2012, the fear of default by some EU members, indicated by rising spread on sovereign bonds is another factor. Finally the ongoing perception of a liquidity crisis in the European Banking system can be interpreted as playing important parts in the creation of the uncertainty. Draghi addressed the OMT at a crucial moment to markets in order to interrupt a vicious circle in uncertainty, massive capital flows and rising spreads. At this point, the key factor was not the difference of spreads on sovereign bonds but rather the risk of convertibility. As empirical studies indicate the market reaction to the speech of Draghi was and still is optimistically positive.

The important question is, why did markets react with great confidence at that time? Draghi’s speech documents the constitutive function of language. The credibility of words cannot be separated from the context of communication and speaking. The context of the ECB is a context of the international monetary system in which the “risks of convertibility” influence international capital movements, hence the Euro and the U.S. Dollar. International capital movements, the balance of payments, are determined by gross capital flow based on „cash-flow-concept”, motivated by „aggressive risk-taking” (Borio & Disyatat 2011, Borio 2013, Calvo 2013). The expectation-building and decision-making process, the communication strategy and credibility of a central bank must be anchored in reference, which should be linked to contemporary world (Muchlinski 2012, 2011). “To me that is the hallmark of credibility ‘matching deeds to words’ “(Blinder 1998). The mandate of the central bank also encompasses the avoidance of liquidity crises (Coeuré 2013). Whether a central bank should be responsible for financial stability is a controversial subject regarding the current literature. A central bank cannot act in favour to stabilize sovereign debt, fiscal policy, growth “and a range of other good things” (Orphanides 2013).

This above question functions as a roadmap to further questions concerning the communication and credibility of the ECB and the Federal Reserve Bank and the international role of the Euro and US Dollar (Ehrmann, Osbat et al. 2013, Goldberg 2013, Winkler, B. et al. 2013).

Key words: Monetary policy, central bank, Federal Reserve Bank (FED), European Central Bank (ECB), communication, transparency and credibility, global financial crisis, exchange rate movements, Euro, US.Dollar, financial stability

JEL- Classification E 44, E 52, E 58, F33
Literature


