Speaking to the masses on monetary policy

By Michael McMahon

To be convincing and credible, communications by policymakers need to be simple, relevant and story based. Typical communications from central banks tend to fail on all three fronts.

Simplified communication from central banks could address twin deficits: the deficit of public understanding and the deficit of public trust.

CONTROL OF INFLATION depends on control of inflation expectations, according to most modern views. The idea is that if workers and firms believe that inflation will be 2 percent, then firms will be wary of pricing themselves out of the market, and will set prices accordingly, and workers will not seek wage increases too high above what they believe everyone will seek.

The committees in central banks that set the policy interest rate (to which most other interest rates are related) increasingly use communication to help manage inflation expectations. In the last quarter of a century, a revolution in central bank communication has taken place. Central banks went from operating in an opaque environment to operating in an increasingly transparent one.

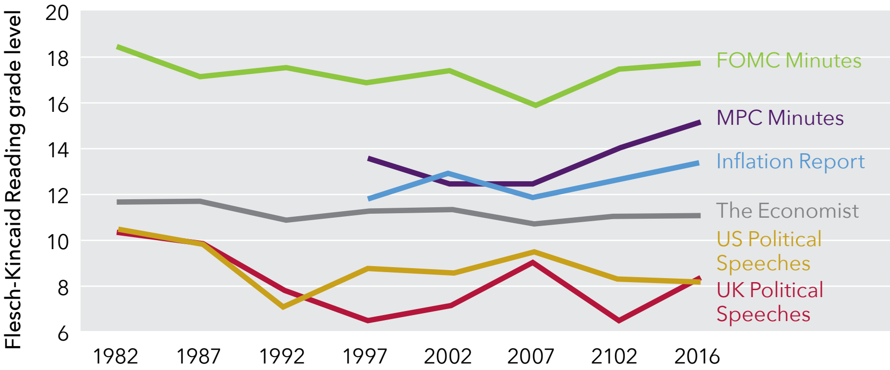
A selective revolution

The members of the Monetary Policy Committee (MPC) at the Bank of England, the UK's central bank, are no exception. They are trying to ensure that people expect them to achieve their objective – that is, to keep consumer price inflation close to its 2 percent target. The committee's efforts involve a huge number of regular speeches and other publications, such as reports and minutes of meetings. But how many people listen to speeches? How many people, every quarter, tune in to get the main messages of the Bank's Inflation Report? The answer is not many.

In fact, while a great deal of evidence shows that communication seems to move financial market expectations of future interest rates, little suggests that the enhanced communications of the last few years have had any impact on expectations or behaviour of the general public.

Nearly a decade ago, Alan Blinder, a Princeton-based economist and former Federal Reserve Governor and member of the Federal Open Market Committee (FOMC, the US equivalent of the MPC) identified that both academic and policy economists may need to "pay more attention to communication with a very different audience: the general public". Despite his call, the communications revolution has been selective. ▶

Figure 1: Readability of various media



Source: Nexis, Project Gutenberg, Bank of England calculations; see Haldane (2017) and Haldane and McMahon (2018). Note: Newspaper articles match a search for 'monetary policy'..

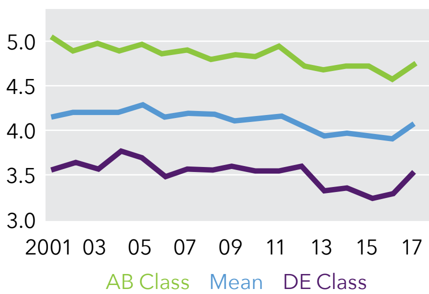
In fact, the selective nature of the revolution has many roots. One is that most of the material that the central bank publishes is beyond the reading comprehension of the vast majority of the general public. To illustrate this, Figure 1 shows the reading level for various publications and speeches. The main Bank of England publications is 14-18 years of schooling (roughly equivalent to university-level), whereas political speeches are around grade-eight level (secondary school).

The communications deficit involves more than a lack of understanding, however. Andy Haldane, the Bank of England's Chief Economist, identified what he called the twin deficits problem: a deficit of public understanding and a deficit of public trust. Such deficits can even be measured. In recent work, he and I use the Bank of England's Inflation Attitudes Survey of UK households to analyse this issue. We show that since 2001:

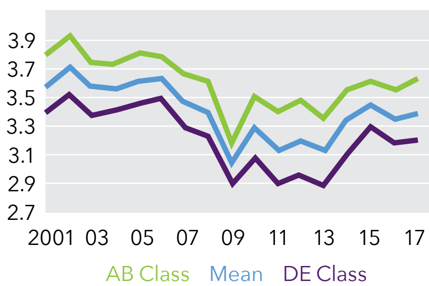
- The public's understanding of monetary policy structures appears to have been largely immune to central banks' communication revolution; the average knowledge score has been flat or has actually fallen slightly.
- Satisfaction with central banks' actions declined during and following the financial crisis, and has yet to fully recover.
- While the pattern found for satisfaction in central banks' actions has been broadly based across demographic groups, there is significant stratification in knowledge scores by age, education and social class (as well as by income). The young, less educated and poor are less knowledgeable; this suggests that the revolution has bypassed large cohorts of society.

Figure 2: Public knowledge of and satisfaction with monetary policy

Knowledge score



Satisfaction score



Source: Bank of England's Inflation Attitudes Survey

Desirability of speaking to the general public

If they are going to undertake the task, policymakers must believe that addressing the public is desirable. Here I suggest four reasons why the mission of trying to broaden the audience for the key messages in the Inflation Report has merit:

First, households account for the largest expenditure component of GDP, so influencing their expectations should be particularly important. Moreover, there is growing evidence that their expectations are shaped by a wide range of factors, and certainly not just asset prices. Robert Shiller, the Nobel Laureate, has recently emphasised a key role for 'popular narratives' in determining behaviour in the macroeconomy. To become convincing and credible, communications by policymakers need to be simple, relevant and story based. Typical communications from central banks tend to fail on all three fronts.

Second, building public understanding through more-targeted communication may help to establish trust in central banks and credibility about their policies. This is an important mission for reasons of political accountability. Senior central-bank policymakers usually have independent control of an important policy instrument but are not typically directly elected. As such, central banks must ensure they meet the terms of their social contract with wider society.

These first two reasons reinforce on another; it may be possible to address the twin deficits together through better communication. Using the Bank of England's Inflation Attitudes Survey and controlling for demographic factors, we show that households reporting greater knowledge and greater satisfaction with monetary policy are more likely to have inflation expectations that are closer to the inflation target. Moreover, satisfaction in central banks' actions is positively correlated with institutional understanding.

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A common driving relationship exists between these concepts; it may be that you cannot build one without the other.

Third, even the traditional audiences for central bank communication, the mainstream media and financial markets, likely benefit from simpler communication. Because these are the main intermediaries of information to the general public, it is of paramount importance that they reflect the messages accurately.

Finally, simplified communications may open a dialogue that can facilitate the flow of information from the general public to the central bank. This can help the central bank to make better decisions.

Feasibility of speaking to the general public

As important, for central banks to invest effort and resources into addressing a wider selection of society, the central bank must be convinced that their efforts won't be wasted. Feasibility is key if they are going to undertake the task.

Addressing feasibility is difficult. Our work uses a novel public survey, and a recently adopted communication initiative by the Bank of England to study the issue. The communication innovation was the November 2017 launch of a new, broader-interest version of its quarterly Inflation Report (IR). This communication had the same economic content as the report itself, but was aimed explicitly at speaking to a less-specialist audience. Importantly, this new content was provided alongside the established (more technical) IR and Monetary Policy Summary. The new content was written for an eighth-grade reading level which compares with the Monetary Policy Summary, written at a 13th-grade reading level.

In our surveys of both the general public and more technically trained, graduate students of economics, we randomised the content which the participants read and explored the effects of reading the new content as opposed to the technical content.

We found that:

- The new layered content is easier to read and understand, even for technically advanced MPhil students.
- Those that read the new layered content tended to develop an improved perception of the institution (important in this era of widespread scepticism of public institutions).
- More straightforward communication boosts the chances that the reader's beliefs, especially those of the general public, move more closely into alignment with the Bank's forecasts.

The message from this preliminary work is that if communication is suitably simplified, there is scope to affect public expectations.

Looking forward

There is still a long way to go in order to address the twin deficits problem, and to improve the public's engagement with central bank communication. The Bank of England's first steps to target communication at the general public seem to hold potential, but more needs to be done. The call to arms from Alan Blinder remains as relevant, if not more so, today. Researchers must further evaluate the benefits and feasibility of broader communication. Central banks will need to continue to innovate by using different media to engage the general public.

Nonetheless, success must be measured, not by the ability to reach everyone, but rather by the ability to extend influence beyond the small minority of technical specialists and information intermediaries who currently form the core of central banks' audience. ◀

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Publication Details

CAGE Working Paper forthcoming "Central banks' blind(er) spot." Andy Haldane and Michael McMahon. 2018.