To manage expectations, central banks need social media savvy

By Howard Davies

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As the global economic recovery strengthens, and central banks move to raise interest rates, they need to improve their communication with the general public. To do that, they should follow the trail blazed by Donald Trump.

As global economic growth gathers pace, with the International Monetary Fund reporting that all of the G20 countries are now in an expansion phase, we are at last entering a process of normalization of interest rates and monetary policy. That shift has been a long time coming, and in 2008 few would have forecast that the impact of the financial crisis that erupted that year would be so durable.

It is fair to say that policy normalization is proceeding at different speeds in different places. The US Federal Reserve is furthest ahead, having already lifted rates twice, while in the Eurozone and Japan, normalization is more anticipated than experienced. But the general direction of change is clear.

In the Fed's "Semiannual Monetary Policy Report to the Congress," Fed Chair Janet Yellen forecast "gradual increases in the federal funds rate." At the same time, the Fed is already reducing its holdings of US Treasury bills and mortgage bonds. In other words, so-called quantitative easing (QE) is being replaced in the US by QT, or quantitative tightening.

The European Central Bank has been less clear about its intentions, but has sounded notably more optimistic about growth in the eurozone, noting that all the job losses associated with the crisis have now been offset. A tapering of eurozone QE is now widely expected. For the Bank of England (BoE), Governor Mark Carney has emphasized the need to raise rates in the near future, given that UK inflation is well above target.

But it is clear that central bankers are nervous about moving rapidly, and are worried about the potential impact of policy tightening on financial markets. They are right to be anxious. Interest rates have been ultra-low for a long time. The last upward move in London was a decade ago. For most of today's inhabitants of bank trading floors, that is ancient history.

So one can sense that the monetary authorities are very concerned to prepare the ground for their next moves. They are persuaded that influencing expectations is critical. If markets expect a move, some of the needed adjustments will take place in advance, reducing the potential cost of change.

Central bankers have done a decent job of managing market expectations, certainly in the United States. There cannot be many people in the financial sector who will be surprised if the Fed raises rates again this year.

Preparing opinion for a move is more complicated in the United Kingdom. The voting system used by the BoE's Monetary Policy Committee makes it harder for the governor to know when a majority for tightening will emerge, and some members' views have been oscillating in recent months. Still, Carney has been doing his best to drop heavy hints about his own intentions.

But although financial markets may be prepared, can we say the same of individuals, households, and small businesses? Consumer debt remains high in many places, and certainly in the UK there are few signs that the prospect of higher interest rates is dissuading consumers

from taking on more debt. There is clearly a risk that consumers may react more sharply to rate increases when they eventually occur.

Of course, central banks do not normally speak directly to consumers. They must rely on their messages being passed through several hands, including broadcasters and personal finance journalists, before they reach the high street. The BoE has made some recent efforts to address consumers, but its direct reach is inevitably modest.

And there is evidence that communications by central banks are not well suited to the consumer market. In an intriguing recent speech, Andy Haldane, the BoE's chief economist, marshals survey evidence on how well central banks are understood by the populations they are trying to influence. Researchers have looked at the reading level required to understand central banks' publications, and at the percentage of the population that reads at that level.

The results are alarming. While about 70% of the population can understand a campaign speech by Donald Trump, and 60% can grasp the significance of the lyrics of an Elvis Presley song, only 2% have the reading ability necessary to understand the minutes of the Federal Open Market Committee.

Now one might reasonably say that no one should expect Joe or Joanna Blow to spend their Saturday evenings reading FOMC minutes. But only slightly more than 20% can understand what the mainstream press writes about monetary policy.

And this is a problem not only for the Fed. The minutes of the BoE's Monetary Policy Committee are somewhat more demotic in style, but not much more. The Campaign for Plain English, a lobbying group, has described the Bank's statements as "worthless, impenetrable waffle." There are no comparable statistics or verdicts for the ECB, but I would be surprised if the results were any different.

The results are a disappointment to central bankers, who, to their credit, have been enhancing their communications in recent years. Not so long ago, a BoE governor took pride in clouding decisions in decent obscurity. In the last 20 years, that curmudgeonly attitude has vanished. But, as Haldane concludes, further effort is needed.

People get their news in different ways nowadays, and central banks, he says, "must ensure they reach the parts of society they previously have not reached, using media they have not previously used, conversing as much as convincing." Trump has shown that he can do it, albeit often with deleterious results. The Fed chair appointed early next year, whether Yellen or a new nominee, should consider following the communications trail Trump has blazed.

Howard Davies, the first chairman of the United Kingdom's Financial Services Authority (1997-2003), is Chairman of the Royal Bank of Scotland. He was Director of the London School of Economics (2003-11) and served as Deputy Governor of the Bank of England and Director-General of the Confederation of British Industry.