

Interview Carin van der Cruijzen, Jakob de Haan

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Voice-Over: Welcome to TrustTalk. Our guests are Carin van der Cruijzen, senior researcher at De Nederlandsche Bank, the Central Bank of the Netherlands, and Jakob de Haan, former head of research at De Nederlandsche Bank and current professor of political economy at the University of Groningen in the Netherlands. Trust in central banks is key for the effectiveness of monetary policy, reaching price stability. They talk about the importance of explaining monetary policy actions to the general public, the need for financial knowledge, the relation between trust and inflation, the main driver of trust in financial institutions, and the communication sensitivity of communication by financial markets. Your host today, Severin de Wit.

Podcast Host: Carin and Jakob. Welcome to TrustTalk. On the website of de Nederlandsche Bank it states, and I'm quoting, "Work on trust, that's what we do at De Nederlandsche Bank". That's a clear mission statement. Why is a high level of public trust in central banks necessary?

Carin van der Cruijzen: Well, a high level of trust in central banks is important for the effectiveness of monetary policy. As you probably aware of, most central banks have an objective of price stability, and it's easier to obtain price stability when inflation expectations are well anchored. And trust in central banks can help to anchor those inflation expectations. And trust in central banks is also important for their independence. So it's going to help preserve the central banks legitimacy and also shield it from political pressure. So that's also a reason why trust in central banks is important. And then the DNB will not only find the trust in central banks important, but also trust in financial institutions. So one of our goals is to contribute to trust in financial institutions. Trust in financial institutions is very important for the well functioning of the financial system. If there's low trust, you can get financial instability. If there's low trust, people won't save, won't get financial advice, so this is detrimental for the consumers themselves, but also for financial institutions, because it is important that people trust you, so that you have a sound customer base and you don't need to spend a lot of money

attracting consumers. So there are many reasons why financial stability is important, and if people save, they also have money to invest in economy. So it's also important for the economy.

Podcast Host: Jakob, you want to add something to that?

Jakob de Haan: If you think about our monetary and financial system for a minute, you realize that it's all based on trust. Why do you accept banknotes? Well, in the old days you would say, well, because it's linked to gold, but these days are long gone. So nowadays, the only reason that people accept banknotes is because of trust. They trust banknotes. They trust the central bank who issues those banknotes. That's why it's important that people keep trust in the central bank. And that's one of the challenges nowadays with higher inflation, of course, many people may start losing trust.

Podcast Host: Yeah, we're going to talk about inflation in a minute. Central banks are increasingly reaching out to the general public to explain their monetary policy actions. What is the major aim of this?

Jakob de Haan: I think there are two reasons why central banks communicate. One is what is called the central bank effectiveness view. So monetary policy becomes more effective by using communication. That type of communication is mainly directed towards financial markets. The second reason why communication is important is because of accountability reasons. Central banks are independent and it's widely believed that independent central banks should be accountable central banks. In other words, they should explain what they do, they should communicate not just to politicians, but also to the general public. And I think that is an important challenge because financial markets, they listen when central banks talk, financial markets listen. But the public in general, well, why would they listen when the central bank talks? So reaching out to the general public is a real challenge.

Carin van der Crujisen: Yeah, I fully agree that's a real challenge to reach the public. I do believe that there has been a lot of improvement in this respect. We know that financial knowledge also from the public at large goes along with higher trust in the institutions, so people that know more about the ECB, they also have more trust in the ECB. So it is indeed important to at

least try to communicate with the public. And I think there are very good steps in that direction, for example, multi-layered communication so that you also provide the communication in an easier way with graphs for the broader public, but also that you reach out to the public via social media. So there are many attempts to reach the public, although it's a challenge, of course.

Podcast Host: Jakob, you mentioned already inflation. I'd like to talk about the subject because it dominates the economic news at the moment. After a long period of very low inflation, the public was led to believe inflation was something of the past. As we now know, that's not true. So here's my question: was low inflation the result of central banks' credibility and trustworthiness, or rather, the cause of it?

Jakob de Haan: I think trust and inflation are closely connected. Low inflation will increase trust and credibility of the central bank. So in that sense, the fact that we had for a very long time a low level of inflation, clearly helped increasing the credibility of the central bank. And in turn, that credibility of the central bank contributed to keeping inflation low, because the more people trust the central bank to deliver on its primary objective, the lower inflation expectations will be and therefore the easier it will be for the central bank to realise those objectives.

Podcast Host: Carin, a question to you: in the 2020 study published by the European Central Bank, it was found that higher trust in the ECB lowers inflation expectations on average and significantly reduces uncertainty about future inflation. How does that relate to what we just discussed?

Carin van der Crujssen: Yeah, so that study indeed shows that a higher trust in the ECB goes along with better anchored inflation expectations, so they are closer to the inflation target. We also see this in our own research. For example, I did research with Anna Samarina, Jakob did research with Nils Brouwer, so we kind of confirm that the need trust is very important for the anchoring of inflation expectations. And when inflation expectations are well anchored, if you have a little bit higher inflation than people would not adjust the wages that they ask and the firms would not increase their prices that much. So it's much easier to keep inflation low and to

achieve your target. So it's like a self-reinforcing process that when trust is high, inflation expectations are well anchored you achieve this low inflation and then trust remains high.

Podcast Host: The financial crisis of 2008 resulted in a vigorous public dialogue on the steps that should be taken to prevent any comparable calamity in the future and led to the enactment of a mass of new regulations for financial institutions. Many, however, say that more rules and regulations do not necessarily restore trust. What else is necessary?

Jakob de Haan: I think the main driver of trust in financial institutions is their own behaviour. And of course, that behaviour in turn, is to quite some extent determined by the regulations in place. For instance, one of the things central banks imposed after the crisis was to make sure that banks, for instance, had better capital positions. In that sense, these regulations play a role. But in the end, even if the regulations in place are all fine but financial institutions screw up, the public will lose trust in those institutions. So the fact that some banks in the past really misbehaved and other institutions as well, I think is one of the main reasons why trust in financial institutions and the financial system in general has been so low for quite some time.

Podcast Host: Carin, you wrote your thesis in 2008 on transparency perceptions and how that is related to the amount of trust in the ECB. Has reality over the last 15 years influenced your findings in your doctoral research?

Carin van der Crujisen: Yeah, that's indeed some while ago that we researched that and at the time we wanted to know how consumers perceive the transparency of the ECB. And what we found as well, a lot of people don't even have a perception of the transparency of the ECB, for example, because they do not know that the ECB exists. And there's also like a gap between what they know about transparency and how they perceive the transparency of the central bank and transparency perceptions they do matter for trust. So people that perceive the ECB to be more transparent, they have more trust in the ECB. So what we have seen, of course, is a lot more communication with the public at large, so this is an improvement, so my guess would be that perceived transparency also increased as a result of that, but I also imagine that there are still a lot of people that we cannot reach. We should redo the research of then to find out how much change there was.

Podcast Host: Jakob, you wrote a study with, among others, Alan Blinder, where you survey a rapidly growing literature on central bank communication with the general public. Why is this more challenging than communicating with expert audiences?

Jakob de Haan: I think the main reason we already alluded to, namely that the public is not interested. You know, why would you, as an ordinary citizen, listen to the European Central Bank? You know, if you are a financial expert, of course, you listen very carefully because everything the central bank tells you may be useful information for its future policy steps and therefore for your portfolio decisions. However, the ordinary citizen doesn't care that much about the details of policy decisions, and especially in a situation where inflation has been very low for a very long time, who cares? Nowadays that has changed, yes, so in that sense, there may be a new opportunity for the European Central Bank to really reach out to the general public because the chances are much higher that the public now is interested, because knowing more about inflation, future inflation will be important for almost everyone.

Podcast Host: Because we feel it in our pockets.

Jakob de Haan: Precisely, you know, everything, if you read the newspapers nowadays, there are so many people who have been severely hurt by this bout of inflation and of course, the ECB is in the end responsible for what happens with inflation. So from that perspective, I think nowadays people will be more interested, will be more inclined to listen to the ECB than in the past. And I really hope that the ECB uses this window of opportunity, so to say, to reach out and to convince the public that, yes, inflation is way too high at the moment, but we will take our mandate seriously and bring back inflation. And the more people believe that, the easier it will be for the ECB to realize that objective.

Podcast Host: Well, we just were talking about words, but words matter, especially if they come out of the mouth of the president of the ECB or the president of De Nederlandsche Bank. Who doesn't remember the words from Christine Lagarde in March 2020, where she said, and I'm quote, "The European Central Bank is not here to close spreads"- unquote. These words caused Italian bond yields to spike and sent market volatility soaring. So words matter.

Jakob de Haan: I think I better answer that question because I can do so in my independent capacity as professor of political economy. I'm no longer a central banker. I think this was not a good example of effective communication by the ECB president, to say the least. And by now, we know that it's also not true, because even though the primary mandate of the ECB is not to keep spreads low, but, of course, in the meantime, we know that the ECB has introduced a new instrument which can be used to keep those spreads low, so the ECB may not be there primarily to keep them low, but the ECB definitely has the possibility to do so. This illustrates, by the way, that financial markets listen very carefully to communication because, as you said, interest rates on Italian government bonds increased tremendously after this announcement. And by the way, it was not an official announcement, it was in the Q&A session after

Podcast Host: a slip of the tongue.

Jakob de Haan: a kind of slip of the tongue, yea, a beginner's mistake, if you like. I think she regretted it very much afterwards, but it happens. Wim Duisenberg made a similar mistake not that long after he became president of the European Central Bank. It just illustrates that communication matters because financial markets respond to it. And that's also why it's understandable that most central banks are very, very careful how they communicate, because a slip of the tongue is easily made and may have huge consequences.

Podcast Host: A question for you both. In October, Alan Blinder published his book, "A Monetary and Fiscal History of the United States 1961-2021", which is an engaging history of an interplay of monetary and fiscal policy that would determine the economic fate of the US. What can the ECB or the Dutch Nederlandsche Bank learn from this?

Jakob de Haan: I think that book, in Alan's usual very eloquent way, describes for the case of the US how monetary and fiscal policy has interacted in the course of time. A similar book could be written for Europe. I think the story would be different in the sense that the political influence on the FED is much stronger than on the ECB. The ECB, with perhaps an exaggeration, could be considered as the most independent central bank in the world. It's fairly impossible for politicians to change policies of the ECB, while in the case of the US that is very different. And some politicians in the US did what they were supposed to do, namely not interfere with what the FED was doing. Others, however, interfered.

Podcast Host: We have the recent example of Trump, right?

Jakob de Haan: Yes. And of course, politicians always have the opportunity to appoint someone else at the helm of the central bank. That was what Trump did. It had no effect, because Powell did precisely the same as Janet Yellen and Bernanke before, as they should. And therefore, Trump was very disappointed that despite appointing a so-called political ally on that position, the FED did not do what he wanted the FED to do.

Podcast Host: And you say at the ECB that's virtually impossible to do that.

Jakob de Haan: Politicians may say, but as Wim Duisenberg in the past famously said, "Ik hoor het maar ik luister niet", I listen, but I don't comply. So of course, politicians frequently talk about the ECB and whether the policies of the ECB are justified from their perspective, but the ECB famously does not respond to that. So in that sense, the interaction between monetary and fiscal policy is very different. There's also something which US and Europe have in common, namely that most of the time fiscal policy has been pro-cyclical and that implied that the central bank had to do all the stabilisation and had a very hard task which would have been much easier if the fiscal policies of the countries in the European Union or in the United States at the time were more in sync with the stance of monetary policy. So that's the common denominator between the US and Europe, I think, in general these policies are not sufficiently in sync and that makes the job of the ECB or the FED in that case much more difficult.

Podcast Host: As Covid's demonstrated, we need to remember that the next crisis will not necessarily mirror the last one. Bankers need to look around corners, improve their understanding of longer-term risk, and manage and mitigate those within their power to do so. What is, in your view, the challenges for central banks lying ahead?

Carin van der Crujssen: Well, right now an important challenge is, of course, to keep trust in central banks high in times of high inflation. While we did a lot of research on this topic, we also have a recent research where we look into trust in the supervisors, trust in the central bank. So we focus on the Dutch Central Bank and we look at knowledge about supervision, supervisory tasks. So also knowledge in that field is very low among the general public, but we find that

there is a positive relationship with trust in the central bank. So people that know more about supervision, they are more likely to trust the Dutch central bank. So this is also an area which we should try to communicate more with the public. So I think an important challenge for central banks is really to reach the public.

Podcast Host: Carin, Jakob, thank you very much for this interview for the TrustTalk podcast another subject where we try to show how important trust in our lives is and how important, especially for central bankers trust is and vice versa. So thank you very much for being available and wish you good luck with your work in Groningen at the University and at De Nederlandsche Bank in Amsterdam.

Carin van der Cruijssen: Thanks a lot. It was my pleasure to be here.

Jakob de Haan: Likewise.

Voice-Over: Thank you for joining us for another episode of TrustTalk. We hope that you found the conversation valuable and informative. At TrustTalk, we believe in the power of trust to create positive change in the world. If you believe in our mission, we would greatly appreciate your support. You can help keep TrustTalk going by making a donation on our website at trusttalk.co/donate. Every contribution, no matter how small, helps us to continue bringing you thoughtful and engaging podcasts. Thank you for your support and for listening to TrustTalk. We look forward to meeting you again for future episodes.