Towards the banking union

Opportunities and challenges for Statistics
Session 4: Communicating Statistics

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Objectives of banking union

- Create a more robust, more resilient and more efficient European banking system …
  - Contain risks at both micro-prudential and macro-prudential levels
  - Support greater integration of the European financial sector
  - Create a level playing field across participating countries of high quality in terms of rules, regulations and supervision

Role of communication / statistics

Helps to stabilise expectations and improve legitimacy and efficacy of policy actions …

- Transparency
- Clarity
- Accountability
- Effectiveness

Role of communication / statistics

- Transparency
- Clarity
- Accountability
- Effectiveness

… and the greatest of these is <u>effectiveness</u>

Effectiveness

- Effectiveness can only be assessed against the objective of the policy framework …
- … but objectives of banking union are difficult to define in a quantitative manner.

Financial stability = absence of financial instability

Financial instability: “you know it when you see it”

"An approximate answer to the right problem is worth a good deal more than an exact answer to an approximate problem."

John Tukey

Professor of Statistics
Princeton University

Heat map for indicator of financial instability / macro-prudential risk in the Euro area

Derived from regime switching model of risk of multiple bank defaults derived from CDS prices

Source: Goldman Sachs Global Investment Research

Role of communication / statistics

- Transparency
- Clarity
- Accountability
- Effectiveness

… but there are <u>potential trade-offs</u> amongst these different communication objectives

Trade-off # 1

Transparency *vs.* Clarity

Internal analysis and discussion of available data leading to policy decisions

Transparency reflects whether external presentation corresponds to internal analysis

Presentation of analysis and policy decisions to external audience *(e.g. market participants)*

Internal analysis is inevitably complex and needs to embrace various points of view and debate among them

Clarity of message entails that complexity of internal analysis is simplified, which may compromise transparency

“All models are wrong ...
but some models are useful.”

George E. P. Box

Professor
University of Wisconsin

Empirical model-building and response surfaces
Wiley

Trade-off # 2

Transparency / honesty *vs.* Effectiveness

- In a market environment, there is a danger of feedback effects and thus <u>instability</u> and / or '<u>self-fulfilling prophecies</u>' emerging …

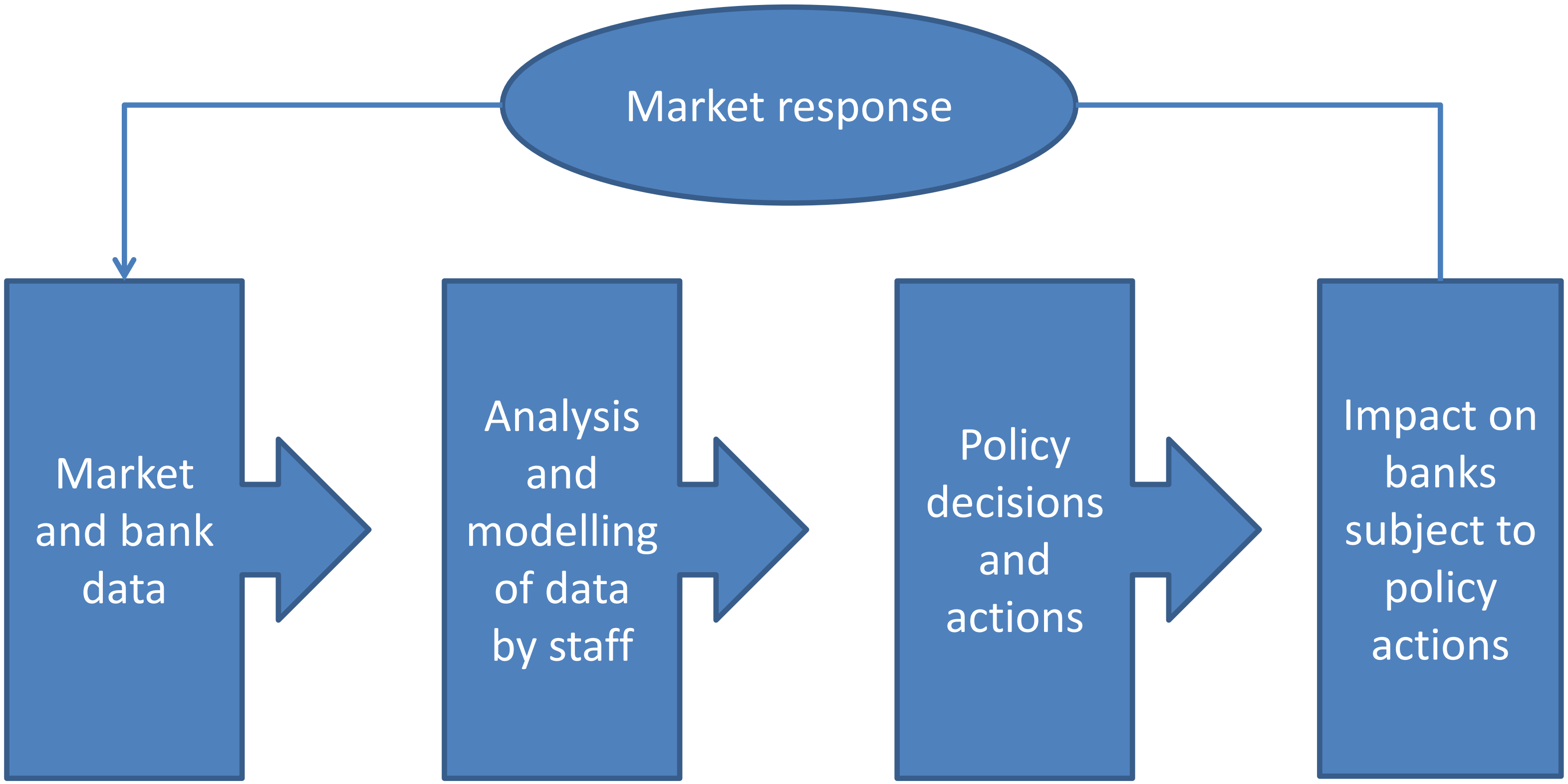
- Monetary policy:
  - "Convertibility risk" and the behaviour of sovereign and banking markets in 2011-12;
  - "Dragging anchor" of longer-term inflation expectations deviating from price stability objective

Trade-off # 2

Transparency / honesty *vs.* Effectiveness

- In a market environment, there is a danger of feedback effects and thus <u>instability</u> and / or ‘<u>self-fulfilling prophecies</u>’ emerging …
- Banking union / prudential policies:
  - Bank run on individual institution
  - Systemic implications of price misalignments / liquidity hoarding, etc.

Managing feedback effects



Ensuring a convergent path

- Do the correct thing …
- … in a timely and pre-emptive manner
- Say what you do …
  - Predictability helps markets interpret information and anticipate policy action, doing the ‘heavy lifting’ on behalf of policy makers
- … and do what you say
  - Credibility is crucial, since this induces stabilising market responses

Ensuring a convergent path

- Design and presentation of statistics (and communication more generally) needs to be fully embedded in the overall policy framework
- Sceptical of an *independent* "communication channel" for monetary or prudential policies
- Better seen as crucial to the design of and as an amplifier for correct policies

"I keep saying that the sexiest job in the next ten years will be that of statistician.

And I'm not kidding."

Hal Varian
Google chief economist

The New York Times,
5 August 2009