How do central banks communicate, and what are the implications of communication regarding the predictability and uncertainty surrounding monetary policy decisions? This question is examined through communication of two world’s leading central banks, the European Central Bank and the US Federal Reserve.

This thesis presents in detail two empirical research papers, Andersson’s “Using intraday data to gauge financial market responses to Fed and ECB monetary policy decisions” (2007) and Ehrmann and Fratzscher’s “How should central banks communicate?” (2005). The main findings of Andersson’s (2007) paper are an increase in the intraday volatility in bond and stock markets on the day of monetary policy decisions, highly pronounced in the US market. Part of this surge in volatility can be explained by the level of the news and also by the revisions in expected future monetary policy path, but the question about what causes the differences between euro area and the US still remains unsolved. Ehrmann and Fratzscher (2005) find that the ECB and the Federal Reserve differentiate in their communication as Federal Reserve being more individualistic in its communication. From the point of view of the effectiveness of communication, their main finding is that a higher degree of dispersion reduces the predictability of the policy decisions and raises the degree of uncertainty.

The empirical part of this thesis partly repeats the work of Ehrmann and Fratzscher (2005) on a different time period, concentrating on the amount of communication, its inclination and the dispersion across committee members. Main findings are that communication overall has increased for both central banks, though this result is subject to the choice of the news service provider used. Another result is that both banks’ communication is more inclined towards tightening than neutral statements, and that the dispersion in the communication is at the same level for both central banks. However, compared to Ehrmann and Fratzscher’s work, dispersion is not found to have any effect on monetary policy predictability. For future research, it would be interesting to see whether this change has only been temporary and what are its implications to future central bank communication strategies.