Upcoming changes in the ECB executive board that could change monetary policy future

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Last week, eurozone finance ministers nominated Ireland's central bank governor Philip Lane to be the next chief economist of the European Central Bank (ECB) after the term of Belgium's Peter Praet ends on 31 May. This position is key within the Governing Council as it has major influence over monetary policy, presenting proposals and providing the economic rationale for action[1].

Philip Lane, 49, has been at the helm of the Central Bank of Ireland since 2015. He has been previously an academic consultant to the European Commission, the International Monetary Fund, the World Bank and several central banks, including the ECB, before taking over the seat on the Governing Council as Ireland's representative. He has extensive experience in financial globalisation.

This year, the central bank faces a broad reshuffle of its key positions, with Draghi's mandate ending in October, and France's Benoît Cœuré finishing in December. This appointment and several that are yet to come arise at a crucial moment for the ECB, when the bank's plans for its normalisation process are complicated by the slowdown in the eurozone economy and weak inflation. In principle, Mr Lane is considered a dove closely aligned with ECB President Mario Draghi, (see below), although with more centrist views on monetary policy (dovish-centrist). This could not imply a significant change from the current policy. Although upcoming changes in the ECB board over the next few months could potentially impact on the speed and scope of the ECB normalisation process. Once the central bank ended its asset purchase programme (APP), the policy discussion shifted to when the first rate hike will take place and the pace of rate hikes. Under Draghi and the current Governing Council, they have been moving relatively slowly. With the substitution of Praet by Lane, it seems that this process would not change significantly; however, if the council would tilt more towards the hawks (the race to replace Draghi and Cœuré is still open; and changes among governors do matter in the discussions of monetary policy), then the pace of the normalization process could pick up some speed.

Tracking ECB member sentiment on monetary policy stance with big data

Using natural language processing techniques, we monitored the ECB members' speeches to disentangle the contents, as well as the sentiment or tone, which is related to hawkish/dovish stances. Having obtained speeches by Mr Praet and Mr Lane from the ECB and Central Bank of Ireland websites[2], we cleaned, processed and transformed the text to understand the main issues that emerge from them[3]. Figure 1 shows the most relevant terms in each ECB member's speeches over the analysed period. As illustrated, terms related to different topics are nicely grouped, with distinct sets of words.

The word clouds or topics are related to the wording used by the ECB members in meetings, or direct comments on graphs or economic results, and most topics are focused on economic issues. As expected, the most commonly used terms used by Mr Praet in his speeches are related to the economy (inflation, growth, prices…) and monetary policy (rates, measures, banks …). Meanwhile, in his speeches, Mr Lane appears to be more focused on Ireland (obviously), as well as on financial and global issues (banking, stability, Brexit …). This will certainly change when Mr Lane performs his new responsibilities.

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[1] The European Council has said it will consult both the European Parliament and the ECB Governing Council. It is expected to adopt its final decision at the next EU summit on 22-23 March.
[2] We obtained all available speeches by Mr Praet on the ECB website (from June 2011 to November 2018) and speeches by Mr Lane on the Central Bank of Ireland website (from January 2016 to February 2019).
[3] Further details on the methodology can be found in Iglesias et al (2017).

Creating Opportunities

Figure 1 Word clouds of the most commonly used terms in speeches by Mr Praet (on the left) and Mr Lane (on the right). The size of the word indicates the frequency with which it appears in the speeches

**Peter Praet**   **Philip Lane**

Source: BBVA Research

We assessed the sentiment in Peter Praet and Philip Lane's speeches (as a proxy for their views on the monetary policy stance) by using the lexicon approach. We used the Loughran/McDonald dictionary (Loughran and McDonald 2009) and the Fed Dictionary for Financial Stability (Correa et al, 2017) in order to identify sentiment charge in the documents (positive or negative sentiment). As positive central bank speeches are associated with positive economic and financial conditions and vice versa, we can interpret the sentiment as a proxy for the degree of hawkishness (or dovishness) of the monetary policy stance. Moreover, given the above, we present the indicator using a normalised index: a positive (negative) value is associated with a statistically more positive (negative) tone than average.

Mr Praet´s sentiment tone in general terms fits very well with the ECB's tone index (figure 2). Across the analysed period, from 2011 until 2018, sentiment dropped steadily from the financial crisis in 2011 to 2016 when sentiment reached its lowest levels. From 2016 onwards, although sentiment has maintained a dovish bias, it has been shifting back towards a more neutral/hawkish stance. More recently, short-term sentiment has been very close to neutral as the ECB is taking steps to normalise its monetary policy, such as by ending the APP. There are no speeches by Praet available since November 2018 but, if anything, sentiment has probably become more dovish in line with other ECB members –as the EZ slowdown is being stronger than expected, risks are mounting to the downside and inflation remains very low-.

The comparison between the two tone indices must be approached with caution (figure 3), as the period in which sentiment tone is analysed for Mr Lane is quite short, from 2016 to 2019, due to the fact that there are no speeches available from the Central Bank of Ireland prior to that date. Moreover, according to the word cloud, Mr Lane's speeches appear to have been more focused on Ireland than the eurozone, in line with his position as the governor of the Central Bank of Ireland. During 2016 and 2017, sentiment was hovering close to neutral, although it initiated a downward trend towards a more dovish tone at the end of 2017, which it has maintained until now. It could be argued that the short period in which speeches are available for Mr Lane may account for the increased focus on Brexit. In fact, Mr Lane's tone becomes more dovish than Mr Praet's since the Brexit referendum and it has remained more dovish since then, perhaps reflecting the impact that Brexit may have on Ireland.

Figure 2 ECB wording sentiment and Mr Praet's monetary policy sentiment
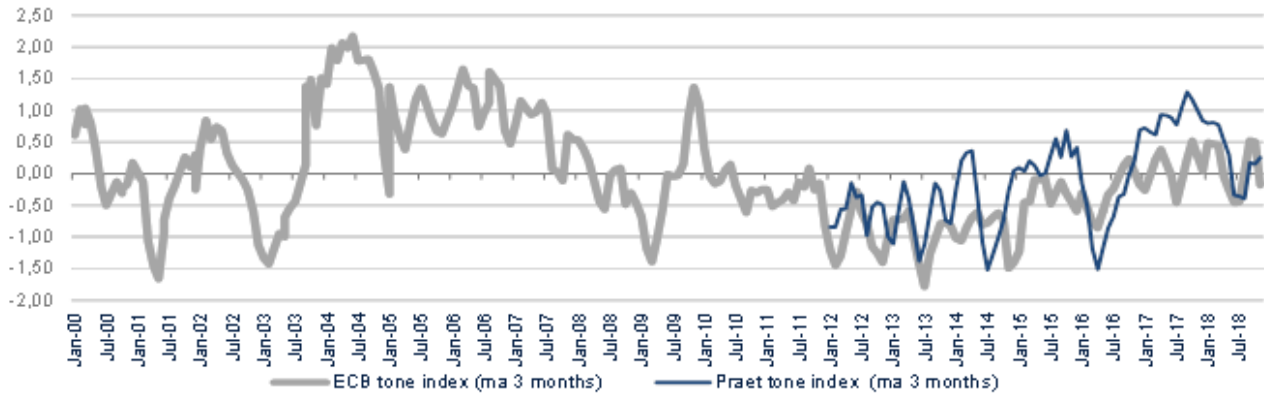
Source: ECB and BBVA Research

Figure 3 Mr Praet and Mr Lane's monetary policy sentiment
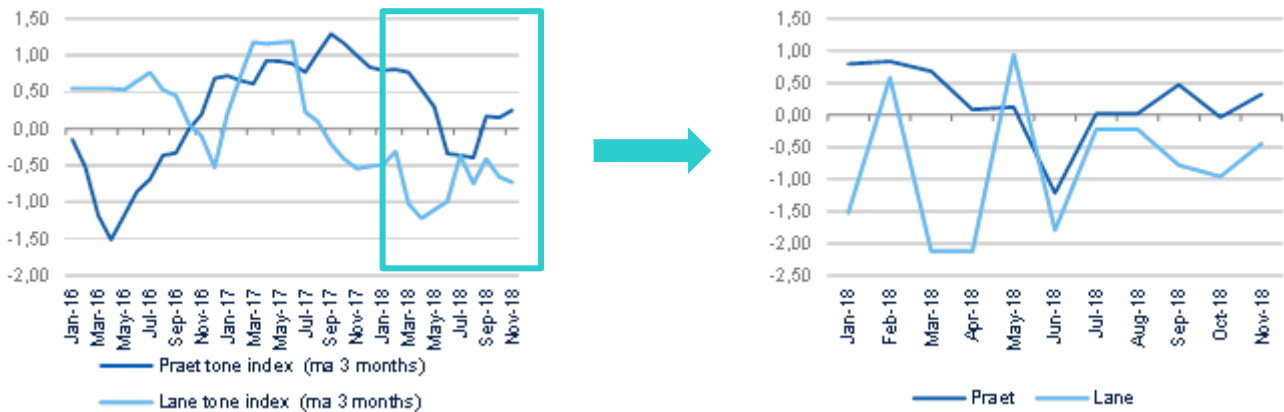
Source: ECB, Bank of Ireland and BBVA Research

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