

# BANK OF ENGLAND'S MONETARY POLICY COMMITTEE – ASSESSING THE IMPORTANCE AND THE IMPLICATION UPON MONETARY POLICY

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## **Abstract:**

*The monetary policy strategies around the world have been evolving in the last two decades considerable. In the past, central banks' have been associated with a „veil of mystery” having at their grounds the so-called policy mystique. Nowadays, the new monetary policy strategy – inflation targeting – promoted by many countries established new coordinates for monetary policy. In this paper we focus upon the monetary policy committee with a special focus upon the Bank of England's case, because of the special track of this committee in several fields: interest rates expectations, other asset prices, the communication of the central bankers, publishing the minutes of the committees.*

**Key words:** *monetary policy strategy, central bank transparency, voting process, communication strategy, voting orientation*

**JEL classification:** D72, D78, E52, E58, E61.

## **1. Introduction**

The conduct of the monetary policy has changed radically since the 1990s. Ehrman & Fratzscher (2005) define transparency in central banking as ‘the absence of asymmetric information between policy makers and the public’. Starting from the importance of the communication mechanism in order to provide, explain and justify the monetary policy objectives, instruments and actions, it can be observed an international *consensus* upon central bank transparency and central bank accountability.

According to Geraats (2002), central bank transparency could reduce private sector uncertainty, give central bank greater flexibility to stabilize economic disturbances and reduce volatility of output. Bernanke (2004) argues that committee members airing their individual perspectives enhances transparency. Issing (1999) suggest the importance of clarity both as the pre-requisite for transparency and for the committees to speak with one voice.

It is important to take into account the type of the strategy applied by the central bank. However, the Bank of England do not follow simple policy rules, as argued by the Mervyn King (1997): ‘mechanical policy rules are not credible – in the literal sense that no-one will believe that a central bank will adhere rigidly to such a rule irrespective of circumstances. No rule could be written down that describes how policy would be set in all possible outcome. Some discretion is inevitable’.

The Bank of England's monetary policy strategy is *inflation targeting* – which could be characterized as ‘constrained discretion’ that's why communication is essential in resolving uncertainty about the course of monetary policy. This is because communication will influence financial markets behaviour and expectations.

According to Lambert (2004), Bernanke et al. (2004) and Eggertsson & Woodford (2003) it is very important the specific use of language and communications in shapping interest rate expectations, because expectations have a crucial role in the decision-making of the monetary policy. Whether financial markets will react finally to

the Bank of England's communication will depend, ultimately, upon the news enriched in the central bank communication process as well as on the extent of which market participants have a high degree of openness regarding the central bank 'words'.

In this paper we have been focusing upon the importance of assessing central bank Monetary Policy Committee with a special focus upon the Bank of England's case. It was important in this sense to analyze the theoretical considerations upon Monetary Policy Committee by gathering the *best practice* Monetary Policy Committee procedures. It was also important to evaluate the Bank of England policy strategy in order to observe the monetary policy changes by adopting in 1992 the inflation targeting strategy and the 1998 new Bank of England's charter.

## **2. Theoretical considerations upon the Monetary Policy Committees**

Starting from the 1990s, central bank independence has become the *panacea* of monetary policy. The era of central bank secrecy and mystique is over and central bank governance is being created with a special focus upon three basic elements: central bank independence, transparency and accountability. Moreover, in recent years, many central banks from the developed country group created and defined the importance of the monetary policy committee in the central banking actual practice.

Blinder (1998), Issing (2005) and King (1997) suggest the importance of the decision-making process of monetary policy and the consequently effects of its actions, especially the communication strategy upon short and long term interest rates. Rozkrut et al. (2007) assess the importance of the central bank communication mechanism in removing the asymmetrical information between markets and policy makers and its importance in influencing the market expectations regarding the modification of future inflation, output and interest rate paths.

Other authors like Berk & Beirut (2011) indicate that an exchange of views within monetary policy committee, will, in general, be beneficial for the quality of decision making even though it increases correlation in members' voting behaviour. However, communication thus implies an exchange of information that increases the total knowledge available to the Monetary Policy Committee (Berger et al. 2008).

J. de Haan et al. (2007) highlighted two reasons why communication may provide useful success for the central banks. First, communication may be a direct appliance tool for influencing and assessing the market expectations. Second, a very accurate mode of communication, can reduce the asymmetrical information in the financial markets. Hence, Mervin King, Governor of the Bank of England refer to the communication process as the *panacea* of leading people to choose the right decision: 'the more can do to behave in a way that makes it easy for the private sector to adopt a simple heuristic to guide expectation the better. A good heuristic from that point of view would be expect inflation to be equal to target' (King, 2005, p. 12).

The usefulness of central bank communication is debated in terms of enhancing central bank transparency (Woodford 2005, Silbert 2006, Gosselin et al. 2007). These authors' suggest that a good communication strategy and a *mutatis mutandis* process will facilitate the private agents capacity in recognizing the importance of central banks' objectives, targets and strategies. Moreover, authors like Pako (2005), Lapp & Pearce (2000) and Lapp et al. (2003) study the FED's communication strategy, analyzing the predictive accuracy of the information release by the bank, the explanation capacity and the predictability power, the less formal channel of speeches and the post-meeting statements.

Finally, Hayo & Neuenkirk (2010) studied the communication mechanism of the FED's and have come to the conclusion that the FED's indicators emphasize significantly the target rate decisions and improve the explanatory power and the accuracy and

soundness of the speeches made by the members of the Board of Governors and regional Presidents.

### **3. The four types of the Bank of England's Communication System**

Starting from June 1997, the communication mechanism of the Bank of England we can identify four types of communication tools which are used frequently by the central bank in order to fulfill its objectives :

- The Monetary Policy Committee Meetings minutes.
- The Inflation Report.
- Several speeches and depositions made by the Monetary Policy Committee Members.
- Evidence by members of the Monetary Policy Committee to the House of Commons Treasury Committee, and the House of Lords the Economic Affairs Committee (previous known as the Committee on Monetary Policy).

According to the 1998 statute of the Bank of England, the central bank "shall publish the minutes of the [MPC] meeting before the end of the period of 6 weeks beginning with the day of the meeting". Until October 1998 the minutes were published above five weeks after the meeting. On the 8 October 1998, the Monetary Policy Council announced the publication of its monthly minutes on Wednesday of the second week after the meetings take place. The Treasury Committee recommended in a report published on 17 July the following : 'the MPC should give serious thought to whether the minutes can be published earlier insofar as this can be done without lowering the quality of the minutes themselves or the quality of the debate they encapsulate'.

The inflation report represents the main document debating and analyzing the communication system of the committee, having a quarterly publication edition (released in February, May, August and November). The Monetary Policy Committee report within this document the projection regarding some indicators like : output, inflation, unemployment rate, interest rate. Within this report it is also assessed and analyzed the British economy stylized factor, the economic outlook and the *forward – looking* approach for the entire monetary policy and the British economy. This report is accompanied by a Press Conference with an hour sustained by the Governor, Chief economist and Director for Markets at the Bank of England.

Regarding the speeches and the depositions made by the Monetary Policy Committee members it can be seen that on the central bank website is available at the speeches section a whole range of speeches and depositions regarding aspects as: *inflation targeting* – the UK's monetary policy strategy, interest rates and output, the monetary policy strategy and monetary policy transmission mechanism, the external shocks facing the UK's economy. The most popular partisan of those speeches is Mervin King – the Bank of England's Governor ; these speeches made by the Governor receive the most press coverage and commentary, suggesting that might also be watched by financial markets participants.

After the report publication, the Monetary Policy Committee gives testimony to the Treasury Committee. However, it can be observed a *lag* between the publication of the report and the evidence to the Treasury Committee. This will provide a separate opportunity to quiz members, because usually this is taken from 4 or 5 Monetary Committee members, always including the Governor. In our opinion, such testimony made by the Monetary Policy Committee members of the central bank represents an important aspect regarding the impact of communication over the financial markets.

#### **4. The mechanism and procedures of the Bank of England's Monetary Policy Committee**

The Bank of England's Monetary Policy Committee is the ultimate authority in establishing the interest rates which will enable the inflation target to be met. The Composition of the Bank of England's Monetary Policy Committee is the following (according to Table no. 1): Governor (Mervyn King), the two deputy governors (Charles Bean and Paul Tucker), the central bank's Chief Economist (Spencer Dale), the Executive Director for Markets (Paul Fischer) and four external members appointed directly by the Chancellor (Ben Broadbent, David Miles, Adam Posen and Martin Weale) in order to ensure that the Monetary Policy Committee benefits from thinking and expertise in addition to that gain inside the Bank of England.

Each member of the Monetary Policy Committee has expertise and long experience in the monetary policy and economics field. Each member of the committee is independent and can vote in order to establish the appropriate interest rate level for meeting the inflation target. The procedure of the decision – making process is based on the voting procedure and not of a consensus of opinions.

At the committee meeting it is necessary the attendance of a Treasury representative which can discuss policy issues but without voting possibility. The rationale behind this procedure is ensuring that the Monetary Policy Committee is fully informed on an actual basis upon the fiscal policy developments and other relevant aspects of the Government's economic policies. Consequently, the Chancellor, will be fully informed about the current and future developments of monetary policy.

The Monetary Policy Committee meeting are on a monthly basis frequency and are established in order to set the interest rate. The nine members of the committee receive upon the bank's staff the latest data regarding the economic trends and outlook of the British economy. The committee meeting is a two-day affair. On the first day it is updated and analyzed the recent economic indicators, discussing and debating the current economic conditions. In the following day, it is provided to the Monetary Policy Committee members individually a summary of discussions upon the future paths of the monetary policy. At the end of these days, the Governor will be leading the meeting and the members must vote upon the interest rate level. The decision upon the interest rate is taken by the majority of votes made by the members. Next it will be recorded the minutes of the meeting and in the following day announced the interest rate decisions at 12 a.m.

In our opinion, it is important to evaluate the public accountability of the Bank of England. Within its communication strategy, we can identify several important characteristics :

- publishing the Monetary Policy meeting minutes two weeks after the interest rate decisions ;
- the full account of the minutes including the policy discussions and the different views of the committee members ;
- recording the votes of the individual committee members ;
- the need of explaining and justifying its regular actions to the parliamentary committee and the Treasury Committee ;
- regular speeches of the committee members upon the monetary policy strategy, paths and decisions ;
- regional visits of the committee members for a two-tier dialog with businesses, organisations and wide public.

Table 1 The Bank of England Monetary Policy Committee members'

<b>Position</b>	<b>Name</b>	<b>Term of appointment</b>
Governor	Sir Mervyn Allistar King	1 July 2008 - 30 June 2013 (second term)
Deputy Governor	Mr. Charles Bean	1 July 2008 - 30 June 2013
Deputy Governor	Mr. Paul Tucker	1 March 2009 – 28 February 2014
Bank Executive Director	Mr. Spencer Dale	1 July 2008 - 31 May 2013
Bank Executive Director	Mr. Paul Fisher	1 March 2009 – 31 May 2014
External Members appointed by the Chancellor	Dr. Ben Broadbent	1 June 2011 - 31 May 2014
External Members appointed by the Chancellor	Prof. David Miles	1 June 2009 - 31 May 2015
External Members appointed by the Chancellor	Dr. Adam Posen	1 September 2009 - 31 August 2012
External Members appointed by the Chancellor	Dr. Martin Weale	1 August 2010 – 31 July 2013

Source : realized by the author based on the bank of england's website informations regarding the Monetary Policy Committee members

### **Conclusions**

In this paper we have analyzed the Monetary Policy Committee of the Bank of England and it's implication upon the british monetary policy and economy. Consequently we can suggest that the Bank of England's Monetary Policy Committee have a complex means and tool of explaining it's decisions and rationale informing also the financial market participants upon the economic and policy outlook. In this sense the mass-media, the wide public and financial market can evaluate and understand the thinking of the Monetary Policy Committee member strategy. In this sense it strengthens the Bank of England's power to establish the interest rates, fulfilling also the central bank transparency and central bank accountability areas.

The *optimum size* of the nine members of the Bank of England's Monetary Policy Committee members and the impact on their long-time horizon of the interest rate expectations have a direct impact upon the direct and explicit inflation target but with less opportunity for influencing the long-term asset prices. The most relevant information disclose by the Bank of England through different collective form of communication for the most important information is represented by the publication of the *Monetary Policy Committee meetings minutes* and the *Reports* having a strong impact upon the response of the financial markets.

Finally, we suggest that the Bank of England's communication system and the structure and implications of the Monetary Policy Committee is a strong device for translating information to the investors with a measurable impact especially upon the financial market prices. It is important to notice the strongest impact of implied rates from short sterling futures which might be reflected in changes upon the interest rate expectations.

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