

# Groupvote, not Groupthink

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*The opinions and analysis in this presentation do not reflect the views of BNPP AM*

# Motivation

*Apologies to those who have heard this (many times) before.....*

- In a conference dedicated to the MPC and a session dedicated to the decision-making process, worth talking about the votes...
- A lot of focus on the incidence of dissenting votes (hawks, doves, etc.,)
- But relatively little focus on the limited *extent* of the dissent
- Dissent is almost without exception  $\pm 25$  basis points
- In contrast, speeches imply significant dissent on the economics

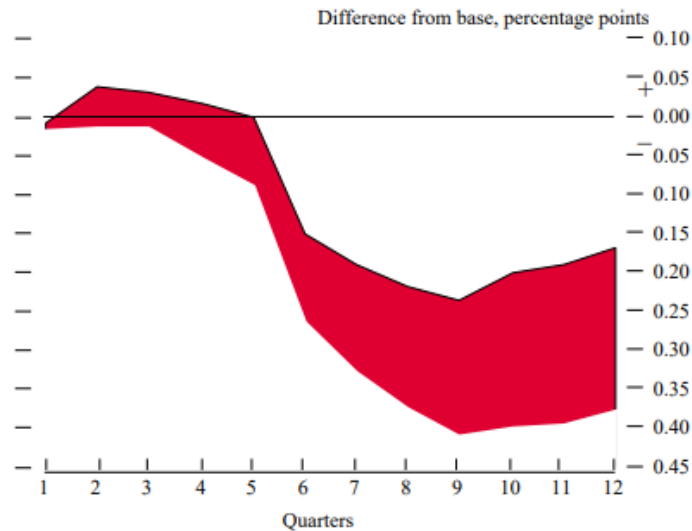
# The MPC is markedly different

Members of the Committee are individually and publicly accountable for their votes. Disagreement among the Committee is inevitable; it is also desirable because it represents the individual judgements of members, rather than an attempt to create a false consensus. It is a source of strength. Over the past ten years, there have been 153 dissenting votes, on average more than one per meeting. This institutional encouragement of open debate is **in contrast to many other central banks. We don't "do consensus"**, as one former member put it. Dissent is more frequent than on other central bank committees which publish individual votes, and is not just token. Table 2 reports the proportion of dissenting votes in four central banks during the period since the MPC was set up. Not only is the number of dissenting votes greater on the MPC, the frequency of more substantive disagreement – where one quarter or more of the voters dissented – is markedly greater.

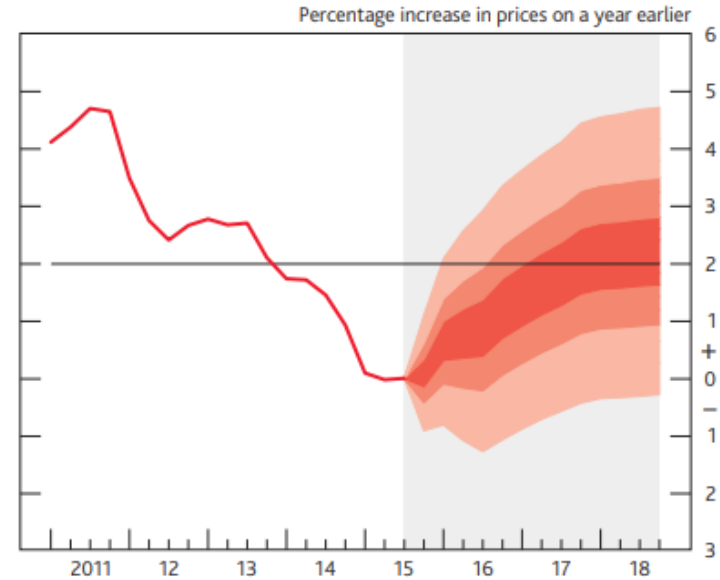
**Some of the other central banks have a token dissent, or one odd ball, but what this is saying is, "no, we're markedly different" in that a significant amount of dissent is normal.** That reflects the fact that this is genuinely a committee in which people feel under great pressure to say what they really think and that's the principal part of how the committee operates. **That you get better decisions if you ask the nine people to say what they really think, instead of asking them to sit round and try and come to a consensus.**

# Is 25bp significant? Ask the MPC

Effect on inflation rate, relative to base, of 100 basis point increase in the official rate maintained for one year



November 15 IR fan chart



- Buiter → 25bp is “chicken feed”
- 25bp on Bank Rate *for 1 year* implies less than 10bp on inflation at Year 2
- 10bp is trivial relative to the uncertainty around inflation at that horizon according to fan chart
- Why do we only see “token dissent” in the votes? Are members voting what they think?

# Explanation (1) - Groupthink

- Votes reflect true extent of disagreement within MPC
- 9 economists almost without exception in near-complete agreement (Groupthink)
- This seems surprising .... setting monetary policy is not easy
  - Large number of difficult judgements required on structure and state of the economy to construct a forecast and calibrate the appropriate policy setting
  - So how do 9 economists independently arrive at essentially the same answer meeting after meeting, year after year?
- Answer → they do not arrive at their answers independently
  - There is one forecast round and one BoE staff providing analysis
- But how do we explain the differences of view on those judgements on the structure and state of the economy that are apparent in the speeches?
- Groupthink is not a particularly satisfactory explanation

# Aside - Gradualism

- Rich debate on whether the apparent inertia in the policy rate selected by the majority reflects a partial adjustment mechanism
- Familiar explanations
  - Above all, Brainard uncertainty
  - Steering long rates
  - Financial stability

# Aside – “the Brainard homily”

- Rich debate on whether the apparent inertia in the policy rate selected by the majority reflects a partial adjustment mechanism
- Familiar explanations
  - Above all, Brainard uncertainty
    - Model uncertainty sometimes implies respond less aggressively, sometimes more
    - Does the Blinder pause to “watch developments” fit the time series?
  - Steering long rates
  - Financial stability

# Explanation (2) - Gradualism

- Token dissenting votes reflects the same mechanism
  - A partial adjustment to the view of the dissenting member
  - 25 bp is the visible tip of the iceberg of dissent
- Sadly, little explanation of the gradualism mechanism in published comments
  - Do MPC members always believe that the right sort of Brainard Uncertainty applies?
  - Would be a great topic for a future speech
- But dissenting members don't even get a partial adjustment to their view
  - Until you convince the majority, nothing changes
- And dissenting members can even get taken hostage
  - Lars Svensson consistently votes for no change in 2010 and 2011
  - Meanwhile the majority consistently votes to change the stance from 0.25% to 2%
  - Svensson was effectively repeatedly endorsing the hike at the previous meeting



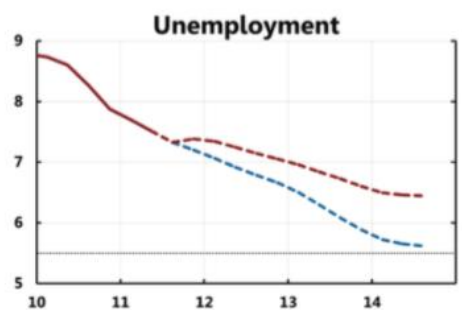
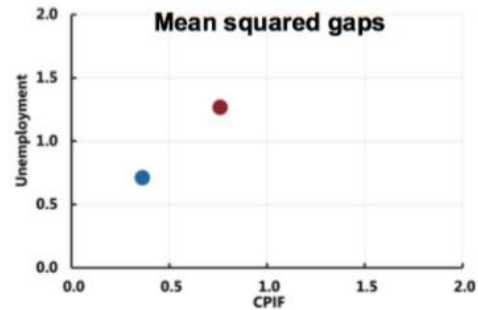
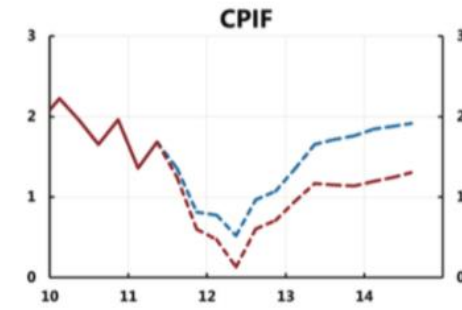
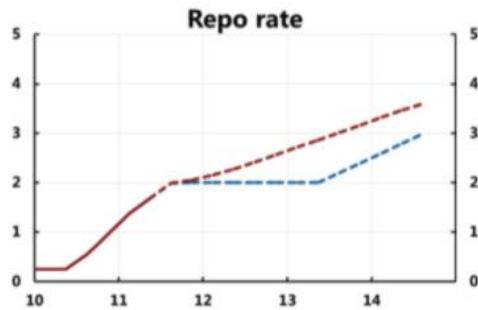
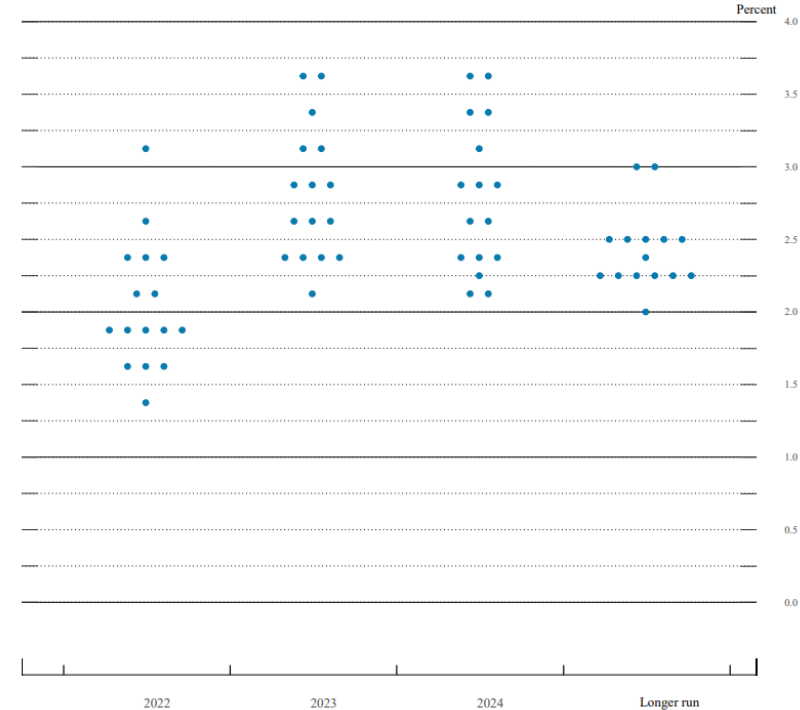
# Aside – Svensson's rebuttal

## Monetary policy alternatives September 2011

Foreign interest rates according to implied forward rates; sustainable unemployment rate 5.5 %



## Latest FOMC dot plot



— Main scenario repo-rate path — Lower repo-rate path

- Svensson did dissent on the rate path – and that dissent was made public
- FOMC members are currently doing something similar
- Does not appear that dissenting MPC members do this – should they?

# Aside – Svensson’s explanation

Why could I not dissent in favor of a single large step directly to an “optimal” policy rate and policy-rate path? This was because of technical limitations in the methods available at the Riksbank to calculate alternative policy-rate paths and corresponding inflation and unemployment forecasts. The methods only allowed small variations from the “main scenario”, that is, the majority’s policy-rate path and forecasts. This meant that my policy-rate paths in practice only showed that that the majority’s path was not optimal and in *what direction* the policy-rate should be adjusted, not *how much* it needed to be adjusted, in order to be optimal.

- Svensson could not calibrate the right jump to the optimal level of rates
- Does the same issue arise for dissenting MPC members?

# Explanation (3) – Negotiation strategies

- If you want to change the policy stance you may need to convince 4 other economists to vote the same way
- Might be easier to persuade them to make a small rate move rather than a big move
- But you will need to be able to repeatedly persuade them to get the big move you want
- And presumably everyone understands this “significant move in rates via many insignificant steps” game because everyone is playing it
- Dissenting members often show their hand
  - They do not tend to hide their views on the economics and the implied adjustment in rates
- Why are economists scared of making large rate moves? Precedent?
- If the slope of the Phillips Curve has got flatter shouldn't the size of the default rate move have increased anyway? Is 50bp still scary?

# Explanation (4) – Signalling

- Large spread of votes may damage the MPC's ability to steer short rates
- But does the MPC even want to steer short rates?
- And doesn't the dissenting member want the market to question the signal sent by the majority?
- And if dissenting members don't want to damage the signal then why publish speeches which call into question the economics on which the majority signal is based?

# Explanation (5) – Collective reputation

- Major disagreements on policy would damage the credibility of the BoE
- But major disagreement on economics do not?
- And policy errors do not?

# Explanation (6) – Personal reputation

- Best not to fail unconventionally
- Argument relies on a big reputational risk in getting the rate vote seriously wrong
- But less reputational risk in getting the economics seriously wrong
- Plausible to a point
  - Harder to prove a speech wrong than a rate call wrong

# Summary: 6 explanations

- Groupthink
- Gradualism
- Negotiation strategies
- Signalling
- Collective reputation
- Personal reputation