

The Society of Business Economists' survey on MPC communications

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This article reports the results of the Society of Business Economists' (SBE)⁽¹⁾ survey of its members' views on MPC communications. The survey found that, when forming a view about interest rate prospects, SBE members looked first at the macroeconomic data. Communications by the MPC were the next most important input. Overall, a large majority of respondents (87%) found MPC communications either 'helpful' or 'very helpful'. But there was some room for improvement. For example, the results suggested that the MPC could have done a better job of explaining how it responded to developments in the data. The enhanced coverage of risks and identification of key forthcoming data releases in recent *Inflation Reports* should help to address this issue. But the MPC's communication strategy continues to evolve, and the survey results will be a useful input to that process.

Introduction

Effective communication is at the heart of successful monetary policy. The interest rates that impact most on the spending decisions of firms and households (such as mortgage rates) are not directly controlled by the MPC. Instead they depend on, among other things, the path that Bank Rate is expected to follow over the future. For these interest rates to respond appropriately to news, market participants need to understand both the way that the MPC sets interest rates, and the news to which it is likely to respond (the so-called monetary policy reaction function). The MPC therefore places great emphasis on explaining its interest rate decisions. Minutes of its policy meetings are published each month; the underlying analysis and projections are reported in the quarterly *Inflation Report*; and individual members regularly elaborate on their views in speeches and parliamentary testimony.

But how effective are these communications? The Bank of England asked the SBE to conduct a survey of its members' views as part of its continuous efforts to monitor and improve its monetary policy communication strategy.⁽²⁾ The survey's twin aims were to discover what kind of information was of most use to private sector economists in trying to anticipate the path of interest rates; and to find out how MPC communications were perceived as part of that process.

About the survey

The survey was conducted between 12 and 29 March 2007 by the British Market Research Bureau (BMRB), on behalf of the SBE and the Bank of England.⁽³⁾ After an initial inquiry, 354 SBE members agreed to participate. They were invited by email to complete an anonymous questionnaire, hosted on a website designed for the purpose. 141 responses were received, a response rate of 40%. A full list of the questions, together with the aggregated results and the underlying (anonymous) individual response data are available on the Bank's website.⁽⁴⁾

The SBE draws its membership from the ranks of professional economists across a wide range of organisations. Just under one third of respondents worked in professional services, and just under two fifths in either banking or other financial occupations (**Chart 1**). While MPC communications are aimed at a diverse audience, SBE members are representative of an important constituency: indeed, 88% of respondents reported that it was 'reasonably' or 'very' important to form a view of interest rate prospects as part of their job.

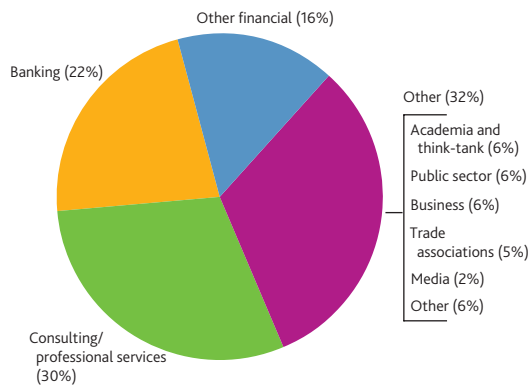
(1) The Society of Business Economists is the leading industry association for UK business economists.

(2) Previous Bank of England studies have investigated how financial markets respond to MPC communications and policy decisions — see for example Reeves and Sawicki (2005) and Bell and Windle (2005).

(3) The results were previewed in King (2007).

(4) www.bankofengland.co.uk/publications/quarterlybulletin/sbesurvey2007.xls.

Chart 1 Composition of respondents^(a)



(a) Excludes two 'Do not wish to answer' responses.

What did the survey find about how interest rate expectations are formed?

The idea that the MPC responds to developments in the economy appeared to be well understood by economists. Respondents were asked to indicate the usefulness of four broad categories of information in forming their view of interest rate prospects — data, MPC communications, views of other commentators, and other — by allocating a total of 100 points across these categories. Data were by some distance the most useful input in forming views about interest rate prospects, especially at longer horizons (**Chart 2**).

A range of data was considered useful in informing views of interest rates at both three-month and 12 to 18-month horizons (**Chart 3**). Official data on real activity and costs and prices, survey data, and data on asset prices and financial institutions' balance sheets all received more than 15 points on average out of 100 at both horizons.

The usefulness of the various MPC communication channels varied by horizon (**Chart 4**). Understanding differences of view among Committee members appeared to be an important part of assessing near-term rate prospects: respondents found the minutes and the vote more useful for forming views of interest rates at short horizons than at longer horizons. But for rates 12–18 months ahead, the MPC's collective assessment of the outlook, as reported in the *Inflation Report* and the accompanying press conference, carried most weight.

This pattern is consistent with the idea that MPC members may differ in their assessment of the conjuncture and outlook, influencing their view of the appropriate level of interest rates in the near term; but that these differences contain less information for interest rates further ahead, because they will typically be resolved as new data become available.

Chart 2 What types of information were useful in forming a view of rate prospects at three-month and 12 to 18-month horizons?^(a)

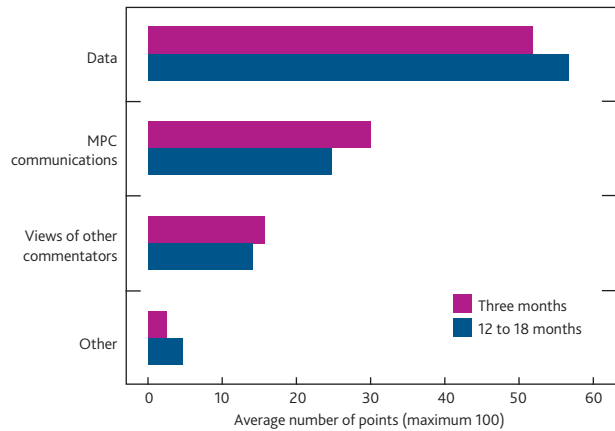


Chart 3 Which types of data were useful in forming a view of rate prospects at three-month and 12 to 18-month horizons?^(a)

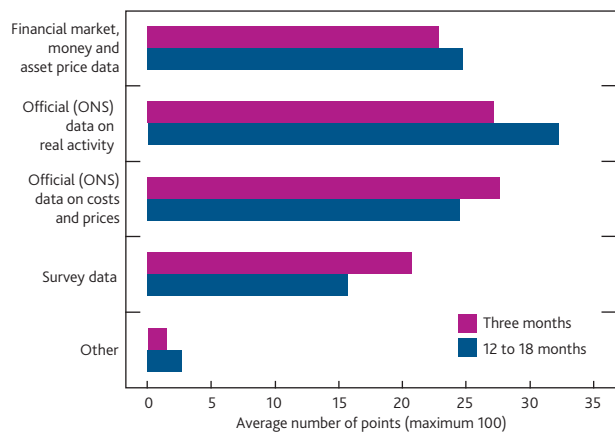
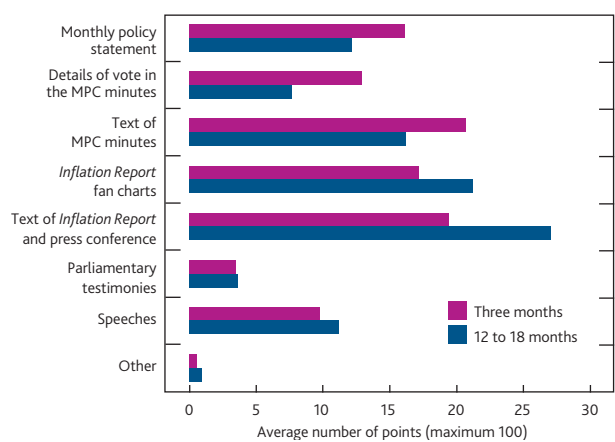


Chart 4 Which types of MPC communication were useful in forming a view of rate prospects at three-month and 12 to 18-month horizons?^(a)

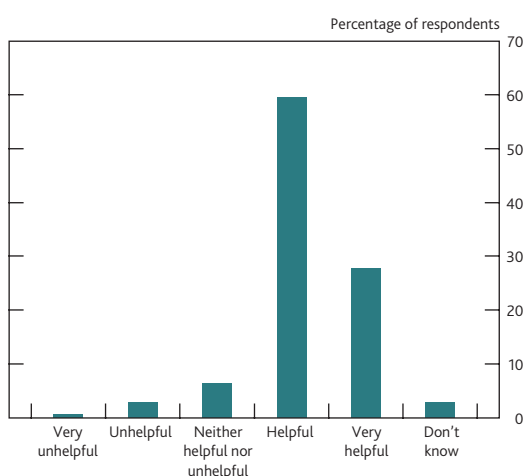


(a) Respondents were asked to allocate 100 points across the available answer categories. The bars in these charts report the average number of points allocated to a category. Respondents for whom it was 'Not at all important' to form a view of interest rate prospects as part of their job could choose not to answer these questions. Only respondents allocating at least 25 points to 'data' in **Chart 2** were invited to answer the more specific questions about types of data in **Chart 3**; and likewise only those allocating at least 25 points to 'MPC communications' in **Chart 2** were asked to answer the more detailed questions on types of MPC communications in **Chart 4**. The number of respondents for each question was as follows (percentage of total respondents reported in parentheses): **Chart 2**: 132 (94%) for 'three-month horizon' and '12 to 18-month horizon'. **Chart 3**: 126 (89%) for 'three-month horizon'; 122 (87%) for '12 to 18-month horizon'. **Chart 4**: 94 (67%) for 'three-month horizon' (excluding one 'Don't know'); 62 (44%) for '12 to 18-month horizon' (excluding two 'Don't knows').

What was the perception of MPC communications?

The key aim of monetary policy communication is to explain the reasons for monetary policy decisions. Building understanding of how monetary policy operates enables markets, businesses and households to anticipate the path for policy, and also to adjust those expectations in response to new information. Overall, a large majority of respondents (87%) found MPC communications either 'helpful' or 'very helpful' (Chart 5).

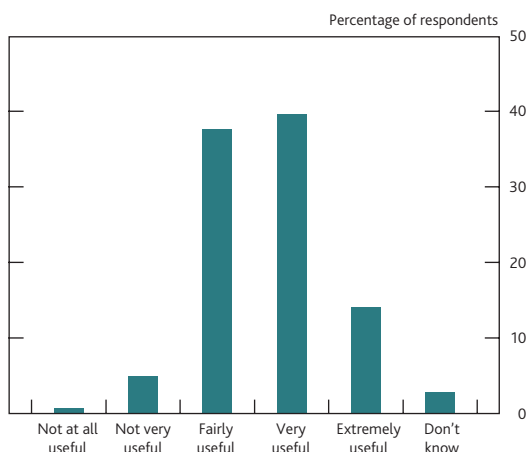
Chart 5 Overall, how helpful were MPC communications?



The survey's detailed assessment of the effectiveness of MPC communications was broken into three parts. First, how well did the MPC get across its interpretation of developments in the data? Second, did it explain how policy actions were linked to the data? And third, were its communications useful for forming a view about the path for rates?

The survey responses showed that the MPC was thought to do a good job of getting across its interpretation of the latest data (Chart 6). It was seen as a little less successful at

Chart 6 How useful were MPC communications for forming views of how MPC interpreted the latest data?



communicating how it responded to these data (the bars on the left-hand side of Chart 7 are larger than those on the left-hand side of Chart 6), suggesting that there was room for improvement in communicating the way policy actions were linked to the data. Nonetheless, over 40% of respondents judged MPC communications to be 'very' or 'extremely' useful for forming a view of near-term rates, compared to 18% judging it 'not very' or 'not at all' useful (Chart 8).

Chart 7 How useful were MPC communications for forming a view of how MPC responded to the latest data?

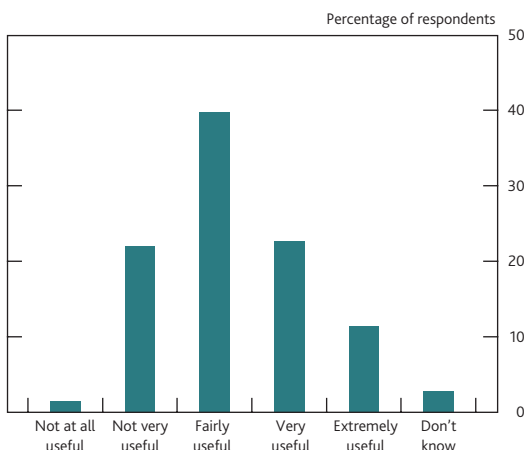
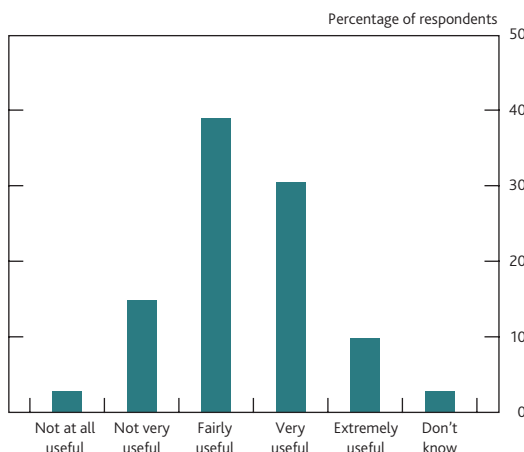


Chart 8 How useful were MPC communications for forming a view of near-term rates?



The MPC places considerable weight on explaining the outlook for the economy in its quarterly *Inflation Report*. A key component of this analysis is the identification of the main risks around the most likely outcome. But did the MPC strike the right balance between backward-looking and forward-looking analysis; and between describing its central projection and the risks around it? Evidence from the survey showed that a substantial majority of respondents thought the balance to be about right (Charts 9 and 10). But among the remainder, there was an appetite for more forward-looking

Chart 9 The balance of MPC communication was:

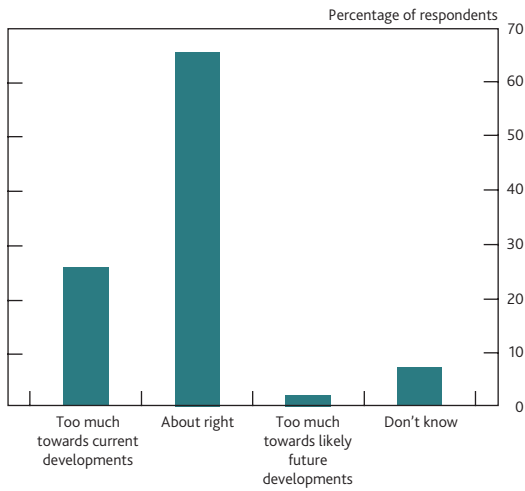
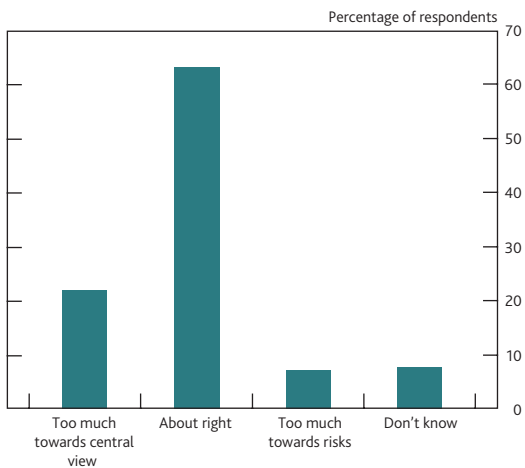


Chart 10 The balance of MPC communication was:



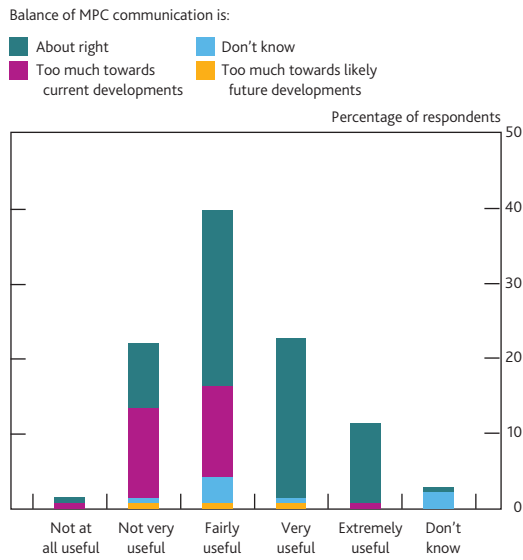
rather than conjunctural analysis, and greater emphasis on risks.

What lessons can be learnt from the survey?

The survey provided some clues about how MPC communications could better meet the needs of its users. Some SBE members thought there was room for improvement in the MPC's communication about the way policy actions related to the data; and there was a desire to see more communication about the outlook, including the risks. Taking these together, one possible interpretation was that providing more information on the outlook and the risks would have helped to make the link between policy and evolving data clearer.

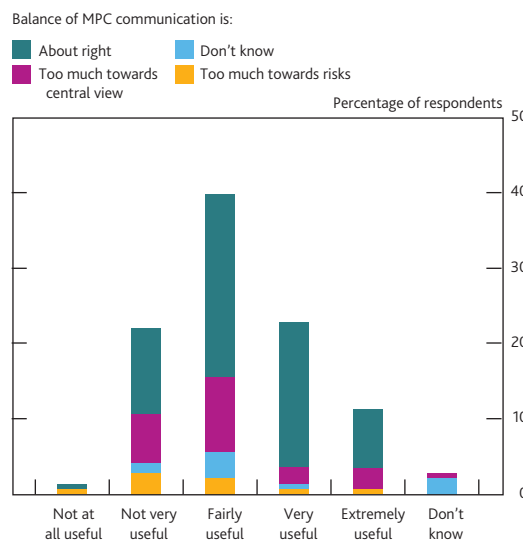
An analysis of individual responses provided some tentative evidence consistent with this story. The minority of respondents who found MPC communications 'not very' useful in forming views of how the Committee reacted to the latest data was also more likely than average to think that the balance lay too much towards communication about current

Chart 11 Breakdown of Chart 7 by respondents' views of balance between explaining current or future developments^(a)



(a) To construct this chart, respondents are divided into groups exactly as in Chart 7. Then the bars are subdivided according to respondents' views on the balance of communication. For example, of the 22% of respondents who found MPC communications 'not very useful' in forming views of how the MPC responded to latest data, a little over half thought communication was focused too much on current developments (represented by the magenta segment of the second bar on the chart).

Chart 12 Breakdown of Chart 7 by respondents' views of balance between communication about central view or risks^(a)



(a) This chart is drawn in the same way as Chart 11 (see footnote to that chart), except that the bars are subdivided according to respondents' views on the balance of communication between risks and the central view.

developments rather than the outlook. This is captured in Chart 11, which provides a breakdown of the information in Chart 7 according to how respondents viewed the balance of MPC communication. The magenta component — indicating that the balance was too much towards communicating about current developments — features strongly in the second bar from the left. Likewise, respondents who did not find MPC communications useful in forming views of how the MPC

reacted to latest data also tended to think that it could usefully have focused more on the risks (Chart 12).

Changes in MPC communications since the survey

MPC communications have continued to evolve since the survey was conducted in March last year, and the survey has been a valuable input to the MPC's thinking. While that process is ongoing, two changes have already been made that should help to address issues raised by the survey results.

First, the discussion of the outlook and the risks in Section 5 of the *Inflation Report* is now structured around the economic issues that are the source of key uncertainties. For example, in the February 2008 *Report* the risks to inflation were discussed in the context of uncertainty about: the extent of the short-term rise in inflation; the prospects for input prices; the extent to which inflation expectations might remain elevated; and the responsiveness of wages and prices to developments elsewhere in the economy. In this way the MPC has sought to provide greater clarity about the main risks to the outlook, and the way in which they might influence inflation if they materialised.

The second change is that the MPC has provided greater guidance on the forthcoming data it expects will help resolve the key uncertainties, and will therefore be of particular importance to monetary policy deliberations in the following months. For example, the MPC stated in the February *Inflation Report* that, in judging the balance of risks to the near-term inflation outlook, it would be monitoring data on global commodity prices, UK import prices and the exchange rate.

The MPC's judgement on whether inflation expectations might remain elevated would depend on surveys of household inflation expectations and companies' pricing intentions, and wages and earnings data.

Taken together, highlighting the contingencies on which the outlook and therefore future policy depends, and highlighting the data most likely to help resolve these uncertainties should make the link between policy and the evolving data clearer.

Conclusion

The SBE survey aimed to explore how economists formed views about the likely path of interest rates. It found that SBE members looked first to the data when forming their view of interest rates, consistent with the fact that monetary policy itself responds to developments in the data. MPC communications were the next most important input for economists in forming expectations of interest rates. The *Inflation Report* carried most weight in assessing the prospects for interest rates a year or more ahead, while the minutes were more important in assessing near-term rate prospects. A large majority of the respondents found MPC communications overall either 'fairly', 'very' or 'extremely' useful. Nevertheless, the MPC is continually striving to improve its communications. The survey has been an important input to the MPC's thinking in this regard. Indeed, the changes in the discussion of the outlook and the risks in the MPC's communications that have occurred since the survey was conducted are consistent with the message taken from the survey results. The MPC will continue to look for ways to improve all aspects of its communications in order to enhance the transparency of the monetary policy process.

References

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