BANK OF ENGLAND

Speech

Overcoming macroprudential inertia: an ambush, and the votes that never were

Speech given by

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It’s a great pleasure to be with you today and to be invited to discuss this important paper.

I first got to know the Bundesbank when I was a rookie journalist at Reuters in Frankfurt in 1975. In those days, the Bundesbank only called a press conference after one of its council meetings when it was expecting – that is to say, when it had already decided – to move the official interest rate. The markets quickly came to understand that the announcement that there would be a press conference was itself the news - the medium had become the message, as we said in those sophisticated times – and the Reuters team would send out alerts, making the yield curve quiver, as soon as old Herr Baum from the Presseabteilung invited us to come in at half-past two.

But the wily vice-president, Dr Otmar Emminger, steeped in the ancestral cunning of the Bavarian intelligentsia, determined to stop all this nonsense. He called a press conference – the alerts went out – the yield curve twitched – the press assembled. “We have no policy changes to announce”, he said. “But in future we shall hold a press conference after every council meeting.” A lot of beer was drunk in Frankfurt that night, and this event, Emminger’s ambush, foreshadowed the curious and now widespread habit among central banks of holding media conferences even, or perhaps especially, when they have little or nothing to say.

Financial Stability Committees, though, have had a lot to say in the years since the financial crisis. This is certainly true of the Bank of England’s Financial Policy Committee (FPC) of which I’ve been a member since its statutory launch in 2013. The remarks that follow will be an attempt briefly to consider some of the key concerns of the Edge and Liang paper from the practical rather than the theoretical viewpoint. How has it felt to daub paint on the vast macroprudential canvas?

The issues raised in the paper that most resonate with me concern responsibility and freedom of action, two sides of the same coin. How are these committees composed; where are they housed; what powers are they given; where do they sit on a spectrum from inactive to hyper-active, and how are these matters related to each other? Behind all this looms the meta-question: are they useful?

I should make it clear that the FPC is a proper policy committee, not the result of what the paper calls “symbolic political delegation”. Goodness, how dreary it would be to find yourself a member of a body that was merely a façade: I wonder if they explain all that when they ask you to join. The FPC has substantial powers, and the direction of the political wind in these early years, with the financial crisis still very much in people’s minds, has encouraged the appropriate use of these powers.

Naturally I believe that the FPC has acted judiciously, and there is no doubt that it has been very active, taking policy initiatives in a number of domains.[1] It is strange, then, that some commentators have claimed the FPC is too timid. My reading of this criticism is that there may be an unusually high level of public

[1] For some examples, see Anil Kashyap’s recent speech ‘My reflections on the FPC’s strategy’.

acceptance for regulatory intervention at the moment. It would be a mistake to suppose that this appetite will necessarily persist. But the FPC has the mandate to take the long view and the difficult decisions that may involve.[2] Its political independence will become even more valuable if the wind changes direction.

Thus we have acted in the contested area of housing with astonishingly little pushback. In particular, we have limited the proportion of mortgage business that banks can write at high loan-to-income ratios. This policy reflected our concerns about the balance sheets not of the lending banks but of the borrowing households. We were keen to limit the build-up of highly indebted households, which tend to be forced to cut spending hard in a downturn and fuel economic contraction.

Since all systemic financial mishaps in recent British history have been related in some way to the housing market, it's hard to see how the committee could be effective if it had decided, as one of its founder members, Sir Paul Tucker, would certainly have preferred, to keep away from housing interventions on political grounds. The accretion of power to unelected officials which Sir Paul discusses in his recent book certainly poses serious questions.[3] It's not unusual, though, to find retired policymakers worrying, in effect, that their successors cannot be trusted with the powers they themselves once enjoyed; I'm told retired burglars often complain that there are not enough policemen about. The crucial point is that parliamentary or congressional oversight of the way these powers are used is necessary to create the environment in which they will not be used carelessly or recklessly.[4]

As well as achieving public acceptance for its actions, the FPC has had to work to allow the markets to understand its reaction function and thus anticipate the manner in which it is likely to respond to any given set of events. Consistency fosters predictability, which in turn will allow the FPC to be unpredictable if it ever chooses to be (but not, I hope, by accident). This should provide a fertile field for academic study when we have a few more years under our belt.

The paper refers to the risk of policy inertia from which I suspect all central bank policymakers suffer. If your decisions are significant, you will be afraid of getting them wrong, and the temptation to wait for one more month or one more quarter of data can be overwhelming. I regard this as a structural issue; I don't see it as professional cowardice. The tipping point comes, though it's not described this way in polite society, when the fear of error through inaction trumps the fear of error from action. Committee members trained in business environments generally want to act sooner, as they are used to suffering adverse competitive consequences in business from being late. They are not always right, and the competitive consideration clearly does not apply in central banking, but their presence may provide a useful antidote to bureaucratic hesitancy.

[2] The FPC's objectives are set out in the Bank of England Act 1998, as modified by the Bank of England and Financial Services Act 2016. The committee also takes its direction from an annual 'Remit and recommendations' letter sent by the Chancellor to the Governor of the Bank of the England.

[3] For a fuller discussion see Tucker (2018) *Unelected Power: The Quest for Legitimacy in Central Banking and the Regulatory State.*

[4] For more on this see Alex Brazier's recent speech 'Citizens in service, not people in power'.

I should stress though that inaction is not always a sign of hesitancy or inertia. Often it reflects the FPC's genuine prioritisation of risks. Whereas some committees are responsible only for flagging potential dangers to the financial system, and so have the luxury of indiscriminately warning about every unturned rock, the FPC has to be more discerning since it is also on the hook for tackling those risks. Put another way, vesting a committee with the responsibility for monitoring and acting on risks reduces the likelihood of 'false positives'.[5]

Edge and Liang put a lot of weight on voting, which they consider one of the hallmarks of a proper committee. Readers of the paper may be shocked to hear that the FPC, though unimpeachably proper, has never yet voted; the Governor as chair is required by statute to seek consensus wherever possible.[6] But any member can call for a vote at any time, and the knowledge that this is the case, along with the desire to avoid the distraction of unnecessary public disagreement, has decisively shaped the process of forming consensus on a few important occasions.[7] In that sense the vote exists, although it has never taken place (I feel Wittgenstein would have relished this). Reading the paper made me better appreciate the importance of this point.

I'll finish with some brief remarks about two other subjects considered at length by Edge and Liang: first, the setting of the UK Countercyclical Capital Buffer rate; secondly, committee composition.

The CCyB: the FPC has, as the paper points out, raised it, cut it (after the 2016 Brexit referendum) and subsequently raised it twice. It now stands at 1% in the UK. Incidentally I love the way the paper decides to "look through" Brexit; I wish we could employ this powerful academic device in real life.

The problems with the CCyB are simply stated:

1. The risk of policy inertia applies in spades. Countercyclical measures are very much easier to describe than to implement confidently, if only because the cycle cannot always be reliably read in real time;

2. The CCyB will tend to be raised only gradually, which means, especially given the time-lag of 12 months prescribed for its application, that it may take too long to build it up to a significant level in an upswing;

3. Its release as risks crystallise is only likely to be effective and valuable if you have plenty of buffer to release. To make it work, then, you first need to build it up to a significant level. I'm not sure precisely what "significant" means in this context, but I rather doubt that the release of a 1% buffer would make much difference to credit supply in a crisis.

[5] I would like to thank Sir Jon Cunliffe for suggesting this point.
[6] Paragraph 11(4), Schedule 2A, Bank of England Act 1998
[7] For more on this, see former FPC member Richard Sharp's speech 'Central bank independence as a prerequisite for financial stability'

This is our major crisis-fighting tool, and we take it very seriously, but no one should underestimate the practical problems of deploying it, or the tensions between the three difficulties I have outlined. The paper points out that it is the stronger committees which are more likely to act on the CCyB. It's certainly easy to see why a less strong committee would really struggle.[8]

A few words on composition and location: the FPC lives in the central bank; it has outside members; the finance ministry – the UK Treasury – is represented on the committee by a member who does not vote under any circumstances; the FPC is distinct from the Monetary Policy Committee and its microprudential homologue, the Prudential Regulatory Committee, but it has substantial overlap of membership with both.[9] At the risk of sounding complacent, this set of arrangements feels good to me. Each committee is able to concentrate on its own field of expertise, while coordination is promoted not only by a degree of common membership but also by meetings involving more than one committee at a time.[10] I fear that merging the FPC with the Monetary Policy Committee, for which some have argued, might very well lead to inadequate attention being paid to financial stability risks. It is difficult to concentrate simultaneously both on central outcomes for an economy and on tail risk.[11]

In the countries where they've been taken seriously, these committees have already begun to prove their worth. Perhaps the oddest thing to contemplate, as I do each quarter when a long list of documents begins to pile up in my inbox, is that ten years ago no one was thinking hard about this stuff. The Bank of England produced an elegant Financial Stability Report, but had no macroprudential powers and in consequence took no action. What, I wonder, are we overlooking, what are we missing now?

[8] For a comparison of the effectiveness of the FPC and the US Financial Stability Oversight Council, see Aikman *et al* (2018) 'Would macroprudential regulation have prevented the last crisis?'
[9] For more on this, see Anil Kashyap's speech 'Come with me to the FPC speech'.
[10] The aforementioned annual letter from the Chancellor to the Bank of England also stipulates that "The FPC and the Monetary Policy Committee (MPC) should continue to have regard to each other's actions, to enhance coordination between monetary and macroprudential policy".
[11] For more on this, see Ben Broadbent's speech 'Monetary and macro-prudential policies: The case for a separation of powers'.

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