



Preference heterogeneity in the CEE inflation-targeting countries

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ABSTRACT

The aim of this paper is to study preference heterogeneity in monetary policy committees of inflation-targeting (IT) countries in Central and Eastern Europe (CEE) during the period 2005–2010. It employs (individual) voting records of the Monetary Council of the Hungarian National Bank and of the Monetary Policy Council of the National Bank of Poland. Preference heterogeneity in committees is not directly observable. Therefore, we pursue an indirect measurement and conduct an econometric analysis based on (pooled) Taylor-type reaction functions estimated using real-time information on economic and financial indicators and voting records. Recent evidence for the monetary policy committees of advanced economies (see Besley et al., 2008 and Jung, 2011) suggests preference heterogeneity among its members is systematic. Unlike for monetary policy committees of advanced countries, the present paper finds preference heterogeneity to be random for both the members of the Monetary Policy Council of the National Bank of Poland (NBP), and the members of the Monetary Council of the Hungarian central bank (MNB). But, similar to the committees of advanced economies, the diversity of views on the inflation forecast is measurable in both committees. A separate cluster analysis shows that different preferences of MPC members may be attributable to their status (chairman, internal member, external member) and that members may also differ in their desired response to changes in the economic outlook.

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1. Introduction

The global march towards greater transparency has reached the countries of Central and Eastern Europe (CEE). In recent years, more information on the monetary policy processes of the CEE central banks has been made available to the public. Overall, inflation targeting frameworks in the CEE countries have performed remarkably well during the past decade. The increased popularity of inflation targeting (IT) has led to visible improvements regarding transparency and accountability in monetary policy. Other main benefits typically associated with inflation targeting are the following. First, inflation targeting successfully lowers inflation and makes it less volatile. Second, it reduces the real costs of disinflation. Third, it anchors long-run inflation expectations. An ongoing debate is whether inflation targeting countries perform better than those that do have other monetary policy strategies. [Blinder et al. \(2008\)](#) suggest that many studies provide clear evidence that the IT strategy has succeeded in anchoring inflation expectations. While most economists would subscribe to this view for advanced economies, it is less clear whether for economies in transition a similar point can be made. In studies that include emerging economies and CEE countries, [Gonçalves and Salles \(2008\)](#) and [Lin and Ye \(2009\)](#) report significant positive effects of inflation targeting, whereas [Brito and Bystedt \(2010\)](#) find that inflation targeting regimes do not lower the costs of disinflation.

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Nowadays, it is widely established practice that monetary policy decisions are made by a committee and not by a single policy-maker (examples of central banks with a single policy-maker in charge of monetary policy are the Reserve Bank of New Zealand and the Central Bank of Madagascar). In committees, as illustrated by the popular Hawk–Doves analogy, it is widely taken for granted that its members have different preferences. Nevertheless, monetary policy committees keep the dynamics of their regular committee interactions confidential (see [Bank for International Settlements, 2008, 2009](#)). If not communicated, policy-makers' individual preferences will therefore not be observed by the public in real-time. More openness on the motives of individual policy-makers and the way they make decisions could help the public to better understand and predict their decisions. Several tools exist by which central banks may communicate the degree of consensus on policy rates among committee members. The conventional spectrum includes transcripts, minutes and voting records of the committee meetings, which to a varying degree and timeliness provide information on the diversity of views in the committee. In the CEE, three central banks (the Hungarian National Bank (MNB) since 2005, the National Bank of Poland (NBP) since 1998, and most recently the Czech National Bank (CNB)) have published (individual) voting records which contain information on agreement and dissent by member shortly after the policy meeting. Such voting records are an important source on diversity among policy-makers in these committees but they have known shortcomings. It has been shown for the Federal Open Market Committee (FOMC) that members of a policy committee may not always reveal their “true” preferences in public (see [Meade, 2005; McCracken, 2010](#)). [Blinder \(2007\)](#) attributes this phenomenon to the practice of policymaking by consensus that would suppress public dissent. Available evidence for CEE countries suggests that voting records may contain valuable information about agreement and dissent by members and about future interest rate moves (see [Horváth et al., 2010](#)).

The present paper aims to study heterogeneity in policy preferences among committee members in those CEE countries for which voting records are available for a sufficient long period. It makes a contribution to the literature by providing and comparing empirical evidence on preference heterogeneity among inflation-targeting CEE countries during the period 2005–2010. Given that neither preference heterogeneity nor diversity of views in committees is directly observable, we pursue an indirect measurement and conduct an econometric analysis based on (pooled) Taylor-type reaction functions. These we estimate using real-time information available from published inflation reports and (individual) voting records. The empirical analysis includes the Monetary Policy Committee of the Hungarian National Bank (MNB) and the Monetary Policy Council of the National Bank of Poland (NBP) during the period 2005–2010.

The paper is organized as follows. [Section 2](#) briefly reviews why heterogeneity is a factor in the monetary policy process involving committees. [Section 3](#) explains the monetary policy process in two inflation targeting central banks in the CEE, the MNB and NBP. [Section 4](#) provides the results from an econometric analysis on preference heterogeneity. [Section 5](#) concludes.

2. Heterogeneity in the monetary policy process

Interactions between members of a monetary policy committee are complex and involve frequent meetings. Extensive internal discussions aim at facilitating a joint assessment of the economic outlook and of its implications for the monetary policy stance. Discussions in committees require considerable staff input. In this respect, [Csajbók \(2008\)](#) finds that inflation targeting central banks and, what he calls consensus-seeking MPCs, rely more on staff input than other central banks. Information by staff is normally accessible by all committee members, and represents information common to all members. Prior to each committee meeting committee members collect information relevant for the policy decision and share the available information and expertise at policy meetings.

Learning among peers has several benefits (see [Blinder et al., 2008; Jung et al., 2010](#)). It is part of the committee interaction and makes monetary policy decisions in the presence of uncertainty more robust. Most central banks provide no detailed information regarding this aspect of the decision-making process by monetary policy committees. The information cascade model (see e.g. [Bikhchandani et al., 1998](#)) suggests that in an uncertain environment committee members do not simply form their views based on their own information set obtained prior to the meeting, but also take into account the opinions expressed by fellow members, speaking earlier during the discussion. An exchange of views about the economic outlook among members in a confidential environment contributes to a well informed decision. At the end of each meeting the committee has to take a monetary policy decision which is either an unchanged monetary policy stance or an adjustment of policy rates.

Diversity across policy-makers is an important feature of voting by monetary policy committees. The literature on monetary policy committees widely emphasises that diversity in monetary policy committees has beneficial effects which makes them superior to single individuals (see [Blinder, 2004; Blinder et al., 2008; Mihov and Sibert, 2006; Bank for International Settlements, 2009](#)). It is thus no surprise that in a clear majority of central banks committees are in charge of interest rate decisions. Nevertheless, the practice of revealing the diversity of views within the committee is far less uniform. Benefits and costs have to be weighed. Revealing diversity may make a central bank more predictable, thereby helping it to better anchor inflation expectations and to smooth volatility. At the same time, communicating diversity may distort the process of accountability, if the committee wants to emphasise collective and not individual accountability.

It is widely observed that committee members have different preferences. For example, [Blinder \(1998\)](#) observes that members in a committee have different preferences and need to compromise positions. For that reason, he suggests that the “central tendency” in a committee is by far more inertial (i.e. less variable) than that of a single policy-maker. Heterogeneity in a monetary policy committee is often related to different skills and backgrounds and to different preferences or views of its members. Most studies though are not clear about the factors driving diversity in the committee. Is it the result of different preferences among

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