

**AN EMPIRICAL ANALYSIS
OF THE INFLATION
TARGETING FRAMEWORK
IN A TIME OF FINANCIAL
AND ECONOMIC CRISIS**

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Outline

- **Aim of study.**
- **Inflation Targeting (IT).**
- **Characteristics of the IT framework.**
- **Econometric Methodology (Panel Data Set).**
- **Policy recommendations and conclusion.**



Objective

- **To review the inflation targeting framework.**
- **To provide an empirical assessment of the performance of inflation targeters and non-inflation targeters during the global financial crisis.**



Inflation Targeting

Inflation targeting is defined as a framework containing an explicit quantitative target for future inflation, a commitment to that target as an overriding objective, a model for predicting inflation, and an operating procedure for adjusting monetary instruments in case forecast inflation differs from its target (Masson, Savastano and Sharma, 1997).

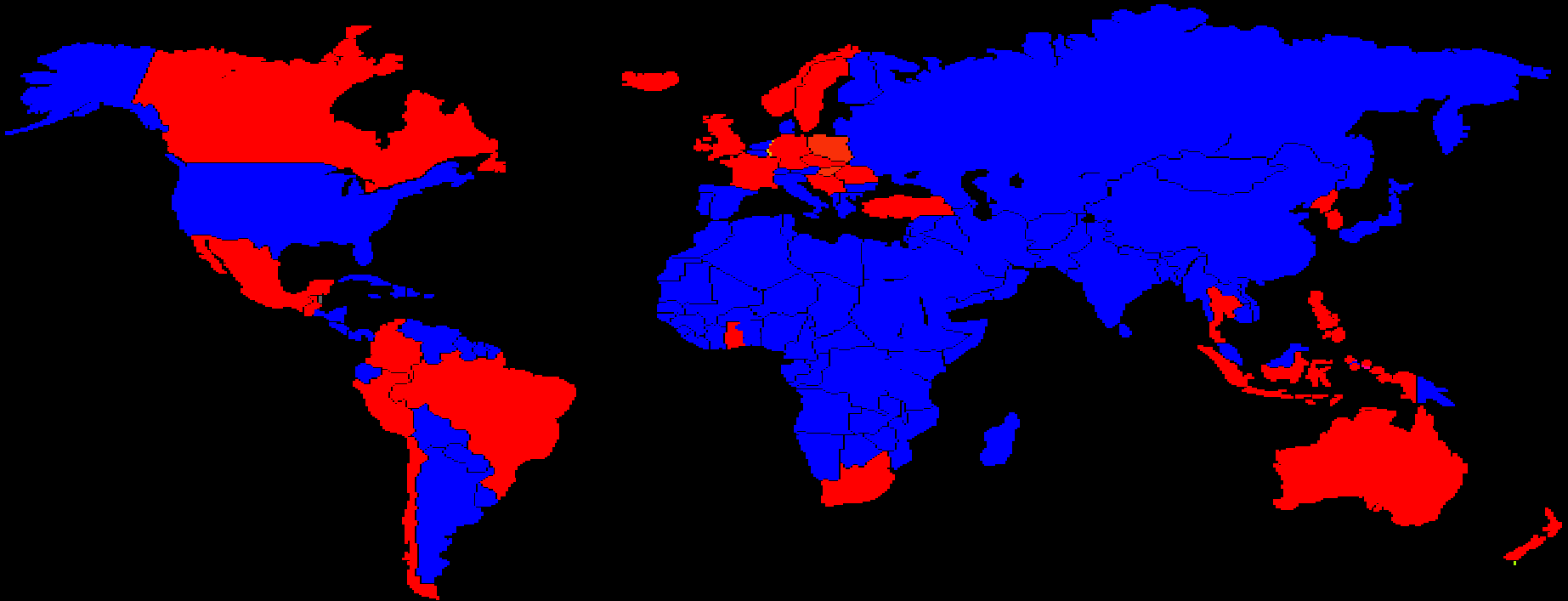


Characteristics of the Framework

- **Announcement of an official numerical inflation target for a specified period of time.**
- **A commitment to price stability as the primary goal of monetary policy.**
- **Perceived transparency and accountability.**



Inflation Targeting Countries



New Zealand	Israel	Thailand	Hungary
Canada	Poland	Korea	Philippines
UK	Brazil	Mexico	Guatemala
Sweden	Chile	Iceland	Indonesia
Australia	Colombia	Norway	Romania
Czech Republic	South Africa	Peru	Turkey
Serbia	Ghana		

Benefits and Drawbacks of the Framework

PROS



Provides a nominal anchor for monetary policy and inflation expectations.



Allows focus on domestic concerns and mitigate shocks.



Enhances communication, promotes transparency & increases accountability.

CONS



Impacts negatively on employment and growth performance.

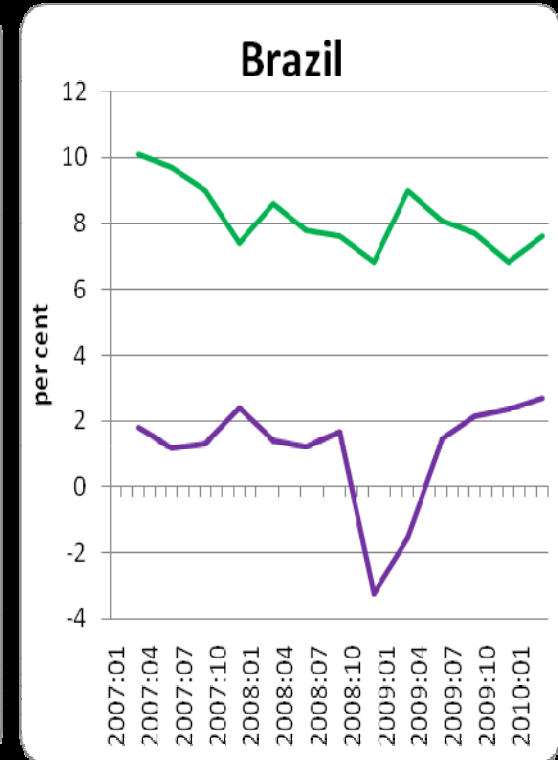
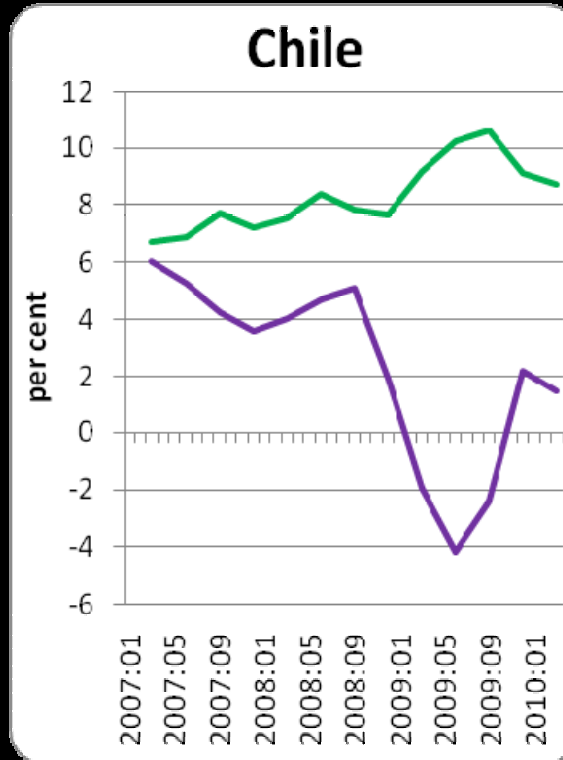
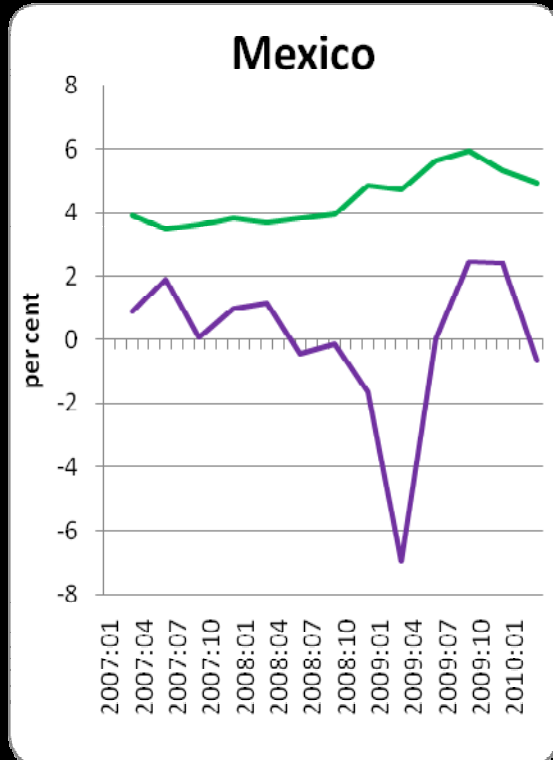


May not prevent fiscal dominance.



Only focuses on consumer price developments.

Snapshot of Selected IT Countries (Latin America)

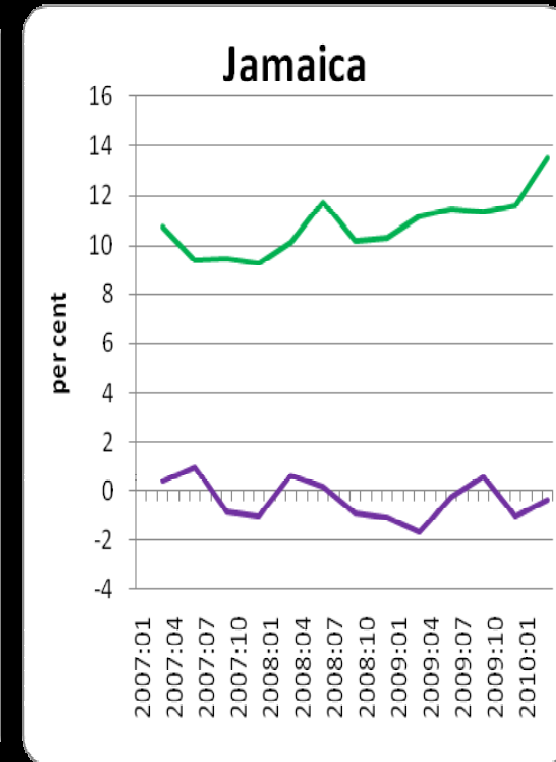
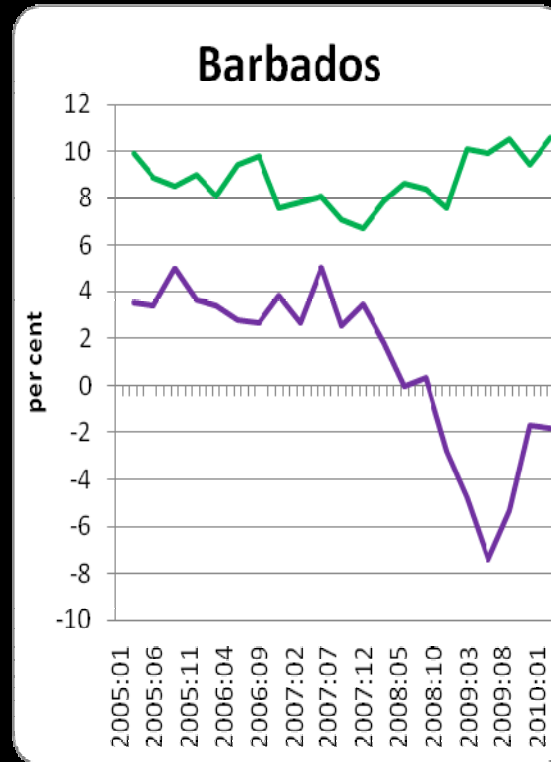
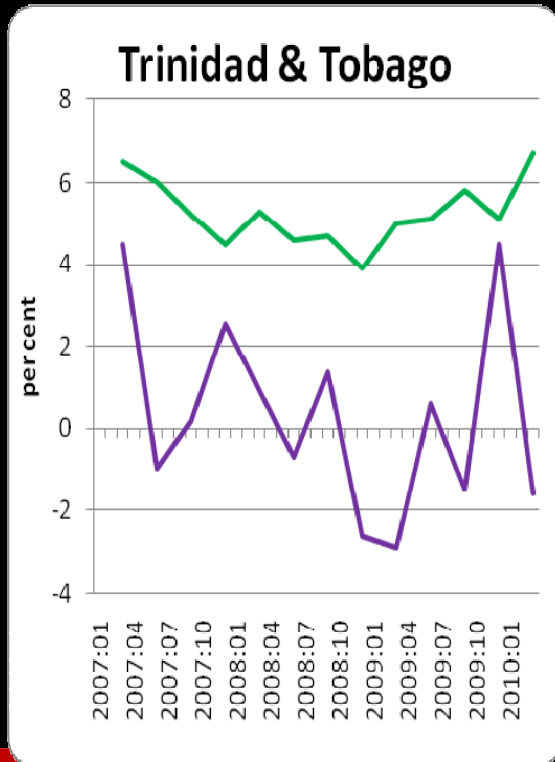


Unemployment

Real GDP



Snapshot of Selected Countries (Caribbean)



Unemployment

Real GDP



Methodology

- Panel data set which comprises 30 countries (Latin America and the Caribbean).
- Data set includes the 6 IT countries in the region.
- Random effects.
- 2007:1 - 2010:3 (monthly and quarterly data).



Model

$$Y_{it} = c + \Phi_t IT + \varepsilon_{it}$$

Where:

Y_{it} is the dependent variable of interest.

Φ_t is the parameter of interest (measures the difference in variable Y_{it} between inflation-targeting and other countries).

ε_{it} is the error term.

Variables:

Policy rate.

Inflation rate.

Real GDP growth rate.

Unemployment rate.



Results

	Policy Rate	Inflation Rate	Unemployment	GDP Growth
IT	-0.317	-1.515	-0.248	0.803
	(0.100)	(1.619)	(0.202)	(1.318)
Observations	771	1137	171	233
Number of Countries	20	29	21	18



Conclusion

- **There was no significant difference between the performance of IT countries and countries with other monetary policy regimes during the global financial crisis.**
- **However, the features of the framework such as transparency and accountability were important to maintain public confidence.**
- **CBTT can consider adopting some key elements of the framework such as transparency and increased communication with the public to assist in managing inflation through inflation expectations.**



Recommendations

- **The inflation targeting monetary policy framework should be strengthened to enhance economic and financial stability.**
- **Policy makers need additional effective and efficient tools since the short-term interest rate is incapable of achieving financial stability.**
- **In addition to price stability, central banks should also aim at maintaining financial stability.**



THANK YOU!

