Assessing the Performance of Inflation Targeting in Emerging Market Economies

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Abstract:

The paper investigates the central banks' operating behaviour using Taylor-type monetary policy reaction function, and addresses the empirical question of whether economies that do not systematically target inflation experience higher macroeconomic volatility as compared with inflation targeters. Initially, reaction function estimation indicates that inflation is more useful for setting interest rate in inflation targeting (IT) economies, but the opposite route for the non-IT economies dominating exchange rate. Meanwhile, volatility measurement analysis indicates that IT economies experience low macroeconomic volatility compared with non-IT economies, but there is a cost through output volatility. Regarding the causal effect on the volatility of exchange rate and other macroeconomic variables, the non-IT economies indicaes that exchange rate volatility increases the instability of most of the variables compared to IT economies.

Keywords: Emerging market economies, Inflation targeting, Macroeconomic volatility

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