Inflation Targeting in Emerging Market and Transition Economies: Lessons after a Decade

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Jeffery D. Amato
Bank for International Settlements

and

Stefan Gerlach
Hong Kong Monetary Authority
Hong Kong Institute for Monetary Research
University of Basel and CEPR

Summary

The announcement of explicit inflation targeting (IT) by a number of countries during the last decade constitutes arguably the most important change in the framework of monetary policy since the collapse of the Bretton Woods system in the early 1970s. While New Zealand and Canada first adopted this framework, it is not always recognised that some emerging market and transition economies (EMEs) launched at the same time policy strategies containing many of the elements of the IT regimes used in more advanced economies.

In this paper we summarise what can be learned from the experiences of the EMEs that have adopted inflation targeting regimes since the early 1990s. Our assessment of the experiences of the EMEs that have employed IT regimes leads us to two main conclusions. First, in most cases IT has been introduced successfully without the economy in question satisfying the preconditions that play such an important role in the literature. Second, exchange rate objectives might play a relatively greater role in EMEs, primarily due to the financial structure of these economies. In particular, during disinflations, inflation targets have coexisted with exchange rate targets, and while there have been conflicts, central banks have typically interpreted the inflation objective as the overriding goal of policy and acted accordingly. As the transition to low inflation progressed, formal exchange rate bands were broadened and, more recently, relinquished. However, the use of intermediate exchange rate objectives has arguably been helpful.