



# **Inflation Targeting; issues for emerging market economies**

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Gill.Hammond@bankofengland.co.uk, Inflation Targeting: International Experience and Romania's Prospects Bucharest, 30 March 2005

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# Key issues for emerging markets

- Institutional “pre-requisites”
- Transparency and accountability
- Technical and operational issues
- Design issues
- Transition



# Inflation Targeters; Start Dates and Initial Inflation



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# Inflation targeting

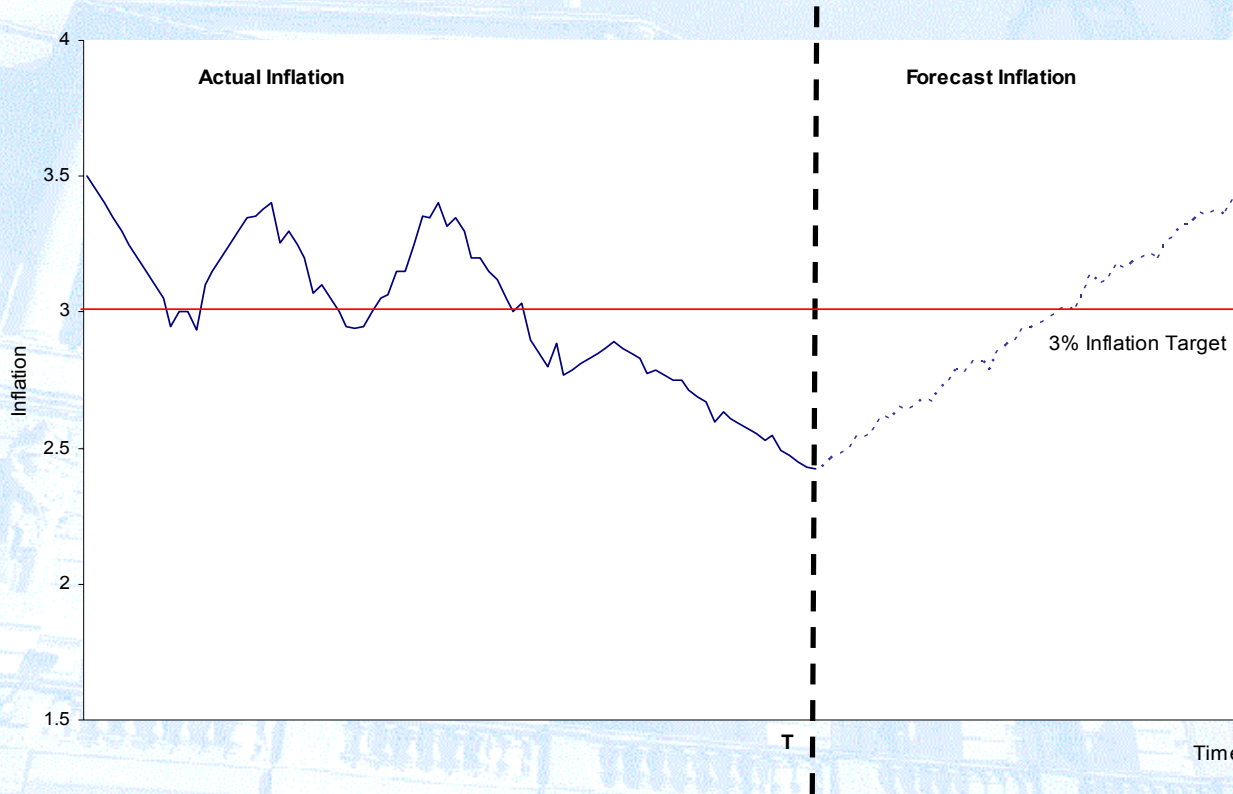


- Public announcement of quantitative target
- Price stability main goal of monetary policy
- Policy based on wide set of information, including inflation forecast
- Increased transparency
- Increased accountability





# Inflation targeting in practice



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# Institutional pre-requisites

- Absence of other targets
- Absence of fiscal dominance
- Sound and well developed financial sector
- Instrument independence



# CB independence: goal versus instrument independence



- Mandate. Ideally the central bank law should define price stability as primary objective and grant independence
- Public perception of political independence
- Instrument independence, ie ability to set monetary instruments at levels consistent with the inflation target



# Financial sector



- Sound and stable financial sector
- Financial sector to be reasonably well developed:
  - Efficiency of monetary and forex operations
  - Asset prices convey correct information
  - Deep and liquid markets absorb shocks





# Institutional framework

- Who should set the target?
- Who decides on interest rates?
  - Governor?
  - MPC?
- Numbers and composition of MPC
- Monetary and fiscal policy co-ordination





# Transparency

- Increased accountability
- Increased efficiency?
  - Monetary policy more predictable and expectations less volatile
  - Reduces risk that asymmetric information leads to market confusion; makes policy actions more comprehensible
- But
  - Only monetary surprises have real effects
  - Information is noisy and may increase volatility





# How to achieve transparency

- Communications
  - Pre-announced target
  - Press briefings
  - Speeches
  - website
- publications
  - **Inflation Report**
  - Minutes
  - publishing forecasts



# Communication issues for inflation targeters



- Publish decision making /minutes?
- Votes?
- Press Conference?
- How much of forecast to publish?
- Publish model?



# Accountability



Why?

- Counterpart to increased CB independence

To whom?

- Minister of Finance
- Parliament
- Public
- Central Bank board

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# Technical and Operational issues

- Need for good macroeconomic data
- Central bank has control over interest rates
- Money market instruments
- Understand transmission mechanism
- Technical capacity to forecast inflation, model economy
- Inflation already low



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# Design issues in IT

- What should the target be?
- Point or range?
- What is the optimal policy horizon?
- Which measure of inflation to use?





# Transitional issues

- Dis-inflationary period
- Moving from fixed to floating exchange rate
- Building technical capacity
- Governance and resource issues



# Conclusions



- Inflation targeting a flexible framework; important to think about details beforehand
- IT is good for communication and accountability
- Institutional factors important
- Needs technical capacity in central bank