INFLATION TARGETING AND MONETARY POLICY: A COMPARATIVE ANALYSIS ACROSS ECONOMIES

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ABSTRACT

Inflation targeting has emerged as a dominant framework for monetary policy in many countries, aimed at maintaining price stability and fostering sustainable economic growth. This article explores the evolution, implementation, and outcomes of inflation targeting across diverse economies, highlighting its benefits, challenges, and contextual variations. By comparing advanced and emerging economies, we analyze the effectiveness of inflation targeting in achieving macroeconomic objectives and discuss the role of central banks, policy tools, and external factors. This comparative analysis provides insights into how inflation targeting has shaped monetary policy in a rapidly changing global economic landscape.

Keywords: Inflation targeting, Monetary policy, Central banks, Macroeconomic stability, Emerging economies, Advanced economies, Price stability.

INTRODUCTION

Inflation targeting, first adopted in New Zealand in 1990, has become a widely used monetary policy framework globally. Its primary goal is to maintain price stability by setting explicit inflation targets, which are typically communicated to the public. This approach enables central banks to anchor inflation expectations, reduce economic uncertainty, and promote sustainable growth. However, its implementation varies across economies due to differences in economic structures, institutional capacity, and external conditions (Bernanke & Mishkin, 1997).

Initially designed to address high inflation in the late 20th century, inflation targeting has evolved as a flexible framework accommodating both inflation and growth objectives. Developed economies, such as Canada, Sweden, and the United Kingdom, adopted inflation targeting to stabilize post-recession economies, while emerging economies, such as Brazil, South Africa, and India, embraced it to combat hyperinflation and currency instability (Cecchetti & Ehrmann, 1999).

Key principles of inflation targeting include transparency, accountability, and independence of central banks. By clearly communicating inflation targets, central banks influence market expectations and enhance policy credibility. Moreover, inflation targeting frameworks typically involve a range, such as 2% ± 1%, providing flexibility to respond to shocks (Duong, 2022).

Advanced economies generally have well-established financial systems, enabling smoother implementation of inflation targeting. For example, the European Central Bank (ECB) and the Bank of England have successfully maintained low and stable inflation. In contrast, emerging economies face structural challenges, including supply-side constraints and exchange rate volatility, which complicate the achievement of inflation targets (Garcia & Cross, 2024).

Brazil adopted inflation targeting in 1999, focusing on curbing hyperinflation and stabilizing its currency. Despite initial success, political instability and external shocks have often disrupted targets. Conversely, Canada's inflation targeting framework, established in

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1991, has consistently delivered low inflation and economic stability, supported by robust institutions and diversified economic activity (Golinelli & Rovelli, 2005).

Central banks play a pivotal role in implementing inflation targeting through tools such as interest rate adjustments and open market operations. Independence from political influence is crucial for credibility, but this remains a challenge in many emerging markets. The U.S. Federal Reserve's dual mandate of price stability and employment contrasts with the single-focused inflation targeting approach, illustrating diversity in monetary policy goals (Mishkin, 2000).

One major challenge is the trade-off between inflation and growth, particularly in developing countries where inflation control might hinder economic expansion. Additionally, external shocks, such as oil price fluctuations and geopolitical tensions, can derail inflation targets. Advanced economies face challenges from persistently low inflation and unconventional monetary policies, such as quantitative easing (Pham et al., 2023).

The COVID-19 pandemic underscored the limitations of inflation targeting as central banks globally adopted expansive monetary policies to support economies. The resulting inflation surges have sparked debates on the relevance of inflation targeting in crisis scenarios and the need for adaptive frameworks (Rochon & Rossi. 2006).

Innovations in monetary policy, such as inflation targeting with flexibility for employment objectives, have emerged to address evolving economic conditions. Tools like forward guidance and enhanced data analytics are enhancing central banks' ability to achieve inflation targets while considering broader economic goals (Santos, 2012).

Regional factors significantly influence inflation targeting outcomes. In Asia, economies like India and Indonesia face unique challenges due to their reliance on imported energy and food. Meanwhile, Europe's integration under the ECB creates distinct dynamics, balancing individual member states' needs with overarching regional goals (Stevanović & Milenković, 2020).

CONCLUSION

Inflation targeting has proven to be a versatile and effective monetary policy framework, but its success depends on contextual factors such as economic structure, institutional strength, and external stability. By comparing diverse economies, this analysis underscores the need for tailored approaches to inflation targeting, ensuring that it evolves to meet the demands of a dynamic global economy. As central banks face unprecedented challenges, innovation and adaptability will define the future of monetary policy.

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