Are international financial crises a relic of the past? Inflation targeting as a monetary vaccine

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A new world financial 'non-system' is emerging consisting of nations with independent central banks that target inflation who let their exchange rates float, usually without controls on capital flows and often without intervention.

The 1990s were plagued by international financial crises. Countries rich and poor, and large and small saw their currency attacked by speculators and their fixed exchange rate policies thrown into the dust-bin of history. The UK in 1992, Mexico in 1994, Thailand in 1997, Russia in 1998, Brazil in 1999 ...the list is long. Yet since the collapse of Argentina in 2001, the international financial system has been an oasis of stability. Some believe this is merely good luck, and that the bad old days will return. They are wrong.

Countries have few choices for their monetary strategy. Historically a large number of countries chose to hitch their monetary policy to a fixed exchange rate. In a world of massive international capital flows, exchange rate fixing subordinates domestic goals of monetary policy – low inflation, full employment and the like – to the exchange rate target. Since this subordination of domestic concerns automatically faces the central bank with conflicting interests, most fixed exchange rates did not stay fixed for long.

In reaction, the past decades have seen many nations experimenting with other strategies – money growth targets, monetary unions and boards, ill-defined or hybrid strategies. Since 1990, a new monetary strategy emerged from the Antipodes; inflation targeting. Inflation targeting requires that the central bank has a numerical inflation target to hit in the medium run in a transparent and accountable fashion, and this should be as the most important objective of monetary policy.

Inflation targeting has met with unprecedented popularity in the stodgy world of
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