Vice Presidency of Sectors and Knowledge
Research Department

Towards a "New" Inflation Targeting Framework in Latin America and the Caribbean

A project of the Latin American and Caribbean Research Network

The Region now includes nine countries with an inflation targeting (IT) regime, including countries that are transitioning to this regime. Frequently, theoretical expositions of inflation targeting consider that the stabilizing instrument is the short term interest rate and the principal objective is to meet an inflation target. However, in practice, inflation targeting central banks use interest rates and a set of other direct or non-conventional tools to meet inflationary and other objectives. The effects of the recent turbulent times in world capital markets in the economies of the Region showed that at times the interest rate and these direct policy tools are used as substitutes, and at other times they have been used as complements. A further consideration is that Central Banks generally have more than one mandate or put another way, inflation targeting in Latin America and the Caribbean has not always been characterized only by a strict adherence to an inflation target. Hence the use of direct instruments may simply be a reflection of the importance of other objectives including output and financial stability.

This research will address whether the switch to inflation targeting in several countries in the region and within that, the use of direct as well as the interest rate as policy tools, may have allowed for greater counter cyclicality and hence whether countries are now in a position to reduce economic volatility. It is hoped that recommendations for the use of different tools in different circumstances will follow to further enhance anti cyclical policies and assist in diminishing the amplitude of economic cycles in the region.

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