

Inflation Targeting in Emerging Market Countries. Too Much Exchange Rate Intervention?: A Test.

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Abstract

Lately, many emerging market countries (EMC) have engaged inflation targeting. But there is ample evidence of ‘fear of floating’ amongst EMC. Limiting the flexibility of the exchange rate has the risk of turning it into an anchor in the eyes of the public. In this paper we test the extent of interest rate defenses in EMC. We find that in some countries they prevented deviations of the exchange rate from its long-run equilibrium value, while other countries seem to have responded to any fluctuation of the exchange rate. We link these findings with measures of liability dollarization, credibility, and pass-through.

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