A New Test for the Success of Inflation Targeting

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Abstract

We propose a new test, derived from a set of variance decompositions of a structural VAR, for the success of inflation targeting. In contrast to standard sacrifice ratios this test considers changes in the structure of real and nominal shocks; second moment effects. We find strong support for IT with 7 of the 9 countries in our sample having negative “sacrifices” and many countries with “benefits”. However, we also find very different performances across IT countries. We find that “IT success” depends on the size of the real shocks suffered but controlling for this there are differences in country performance.

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