Appendix 2

New inflation-targeting countries[1]

The number of countries formally committed to an inflation target as the anchor of their monetary policy has increased rapidly since New Zealand pioneered inflation targeting in March 1990. Inflation-targeting countries are now found in all parts of the world. Inflation targeting stipulates price stability as the formal objective of monetary policy and subordinates other objectives to it. Price stability is defined as a numerical target. Macroeconomic and inflation forecasts tend to play a key role in the conduct of monetary policy with an inflation target, and transparency is an increasingly important feature in communication of policy objectives and implementation. The reason for the growing appeal of formal inflation targeting lies in its success in creating a credible and transparent anchor for monetary policy. At the same time, it leaves monetary policy flexible enough to respond to short-term cyclical fluctuations in the economy without jeopardising credibility.

To date, a total of 28 countries have adopted inflation targeting. Some 26 still target inflation, after Finland and Spain abandoned the regime on joining the European Economic and Monetary Union (EMU) in January 1999. The first inflation target was adopted in 1990; by the end of 1993, five countries formally targeted inflation and five years later their number had grown to ten. In 2004 there were 21, and another five have since joined the group: the developing and emerging market economies of Slovakia, Indonesia, Romania, Turkey and Ghana. This Appendix discusses these five new inflation-targeting countries.

Slovakia

Slovakia acceded to the European Union in 2004. Membership also involved a commitment to join the monetary union and adopt the euro in the future. Countries in the euro area must first fulfil the Maastricht convergence criteria on inflation, interest rates, annual government deficit and government debt. The National Bank of Slovakia formally moved onto an inflation target at the beginning of 2005, viewing this framework as most suitable for fulfilling the Maastricht inflation criterion. The National Bank of Slovakia's current target is to achieve a rate of inflation below 2%, the same as the European Central Bank (ECB). This is consistent with the Maastricht criterion for a rate of inflation no more than 1.5 percentage points higher than in the three EU best-performing countries. In May 2007, inflation in Slovakia measured 2.7%. Slovakia aims to introduce the euro on January 1, 2009.

1. Information on new inflation-targeting countries is sourced from the respective central bank websites. Background information on the evolution of inflation targeting and minimum conditions for adopting it draw on Pétursson, Thórarinn G. (2004), Formulation of inflation targeting around the world, *Monetary Bulletin* 2004/1, 57-84 and Stone, Mark R. (2003), Inflation Targeting Lite, *IMF Working Paper* WP/03/12.

Indonesia

After the Asian financial crisis in the latter part of the 1990s, the Indonesian authorities restructured their banking system and institutional framework. The policy interest rate (BI rate) became a more effective tool against inflation as a result, and Bank Indonesia decided to adopt a formal inflation target in July 2005. It had previously targeted base money, but that proved difficult to control, given that the dominant component is currency outside banks. Bank Indonesia's target is set at 6% for 2007 and 5% for 2008, with a band of ±1% for both years. In May 2007, inflation in Indonesia measured 6%. BI aims to achieve a medium- to long-term inflation rate of 3% so that Indonesia can remain competitive with other countries in Asia.

Romania

After an adjustment phase including institutional reforms to meet the requirements entailed by inflation targeting, the National Bank of Romania formally switched to an inflation target in August 2005. The primary aim of targeting was to drive down inflation and maintain price stability after the target was achieved. A target of 4% was set for 2007 and will be lowered to 3.8% in 2008, with a deviation band of ±1% for both years. Inflation has declined after the adjustment began, which has contributed towards anchoring inflation expectations at a lower rate. In April 2007, inflation in Romania measured 3.8%.

Turkey

The Central Bank of the Republic of Turkey (CBRT) aims to emulate the achievement of developed economies in bringing persistent inflation down to a low and stable level. In order to do so, the CBRT formally moved onto an inflation target at the beginning of 2006. It has set a medium-term target of 4% with a ±2% deviation band. In the first year under the new framework, inflation overshot the target. The CBRT has responded by raising its policy rate, which is higher than Iceland's, and by increasing transparency in order to have more effect on inflation expectations. One step towards transparency is that "the Central Bank shares its forecast about monetary policy verbally with the public." Nonetheless, inflation in Turkey is still well above target, at 9.2% in May 2007.

Ghana

The Bank of Ghana formally adopted an inflation target in May 2007, becoming the second African country to do so (after South Africa). For several years previously, the Bank of Ghana had targeted inflation informally. It has been increasing its transparency and now aims to publish inflation reports. The Bank's target is for a rate of inflation below 10%. Inflation in May 2007 was 11%.

Foreseeable changes in the number of inflation-targeting countries

The number of inflation-targeting countries is bound to change in the next few years. Slovakia will leave the group after some years when it adopts the euro, together with Poland, the Czech Republic and Hungary. Others will possibly follow suit later.

Likewise, other countries may move onto an inflation target. A growing number are currently examining the introduction of targets and several have already launched preparations for formally adopting them. These include the developing and emerging market economies of Albania, Armenia, Guatemala and Kazakhstan, which already have price stability as a stated objective but have yet to adopt a formal inflation target.[2] Fairly lengthy preparations are required before moving onto an inflation target, because central banks must first adapt their own activities to the new policy. Preferably, minimum institutional requirements should be in place before an inflation target is formally adopted. An important consideration is that a central bank should have full independence for attaining its objectives. Also, the domestic financial sector needs to be efficient and developed enough for the central bank's monetary policy measures to be transmitted effectively. Other important fundamentals are financial stability and general economic stability. Although Albania, Armenia, Guatemala and Kazakhstan are at different stages in the adaptation process, they share the aim of formally adopting an inflation target in the near future. Thus these four countries are likely candidates to join the inflation-targeting fraternity within a very few years, and others could join them.

Inflation-targeting countries

Country	*Numerical target*	*Date of adoption*	*Previous anchor*
Australia	2-3%	1993	None
Brazil	4½%(±2%)	1999	Exchange rate
Canada	1-3% (2% central value)	1991	None
Chile	2-4%	1990	Exchange rate
Columbia	2-4%	1999	Exchange rate
Czech Republic	3%(±1%)	1998	Exchange rate and money supply
Ghana	0-10%	2007	Money supply
Hungary	3%(±1%)	2001	Exchange rate
Iceland	2½%(±1½%)	2001	Exchange rate
Indonesia	6%(±1%)	2005	Money supply
Israel	1-3%	1992	Exchange rate
Mexico	3%	1999	Money supply
New Zealand	1-3%	1990	None
Norway	2½%	2001	Exchange rate
Peru	2%(±1%)	2002	Money supply
Philippines	4-5%	2002	Exchange rate and money supply
Poland	2½%(±1%)	1998	Exchange rate
Romania	4%(±1%)	2005	Money supply
Slovakia	0-2%	2005	Exchange rate
South Africa	3-6%	2000	Money supply
South Korea	3%(±1%)	1998	Money supply
Sweden	2%(±1%)	1993	Exchange rate
Switzerland	0-2%	2000	Money supply
Thailand	0-3½%	2000	Money supply
Turkey	4%(±2%)	2006	Exchange rate
UK	2%	1992	Exchange rate

Sources: Pétursson, Thórarinn G. (2004), Formulation of inflation targeting around the world, *Monetary Bulletin* 2004/1, 57-84 and central bank websites.