

THE MIX OF INFLATION TARGETING AND EXCHANGE RATE VOLATILITY: THE ROLE OF EXCHANGE RATE REGIMES

ALI LAMOUCI

Department of Economics, Faculty of Economic Sciences and Management, University of Sousse, Tunisia

ABSTRACT

This paper tends to determine the possible effects on volatility of the real exchange rate due to the adoption of the policy of inflation targeting and to check if these effects vary according to announced and practiced exchange rate regimes. Using the method of two-step system-GMM with a panel of 62 countries covering the period 1987-2011, the results show that among the costs of the adoption of inflation targeting is the increase in the real volatility of the exchange rate. Moreover, we found that, for the two classifications De Jure and De Facto of the exchange rate regimes, the effect of inflation targeting on the volatility of exchange rate depends considerably on the type of exchange rate regime. We also concluded that, as in the developing countries, the Fear of Floating is also justified in the developed countries.

KEYWORDS: Inflation Targeting, Real Exchange Rate, Exchange Rate Regimes, Two-Step System-GMM Method, Panel Data

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