

Abstract

Inflation targeting has become the most popular and widely discussed policy framework in the contemporary monetary policy practice. The success of inflation targeting has been proved by a number of advanced and emerging countries and hence, most of the monetary authorities around the globe have paid attention on the feasibility of adopting such frameworks. However, a country needs to fulfil several prerequisites to adopt inflation targeting in terms of institutional setup, legal framework and the efficacy of policy transmission mechanism. Since the controllability of operating targets and its impact on the ultimate target of inflation is considered as one of the important prerequisites in inflation targeting, this paper attempts to examine the statistical relationships between operating targets and inflation rates in Sri Lanka. At the same time, it is intended to provide a framework for institutional, legislative and operational arrangements with a view to facilitate adopting inflation targeting. This study finds that statistical relationships between operating and final targets are not sufficiently strong, persistent and significant in the Sri Lankan context; however there are signs of emerging relationships. Those would persist with matured economic structure and developed financial markets, enabling adopting inflation targeting in Sri Lanka in future.

JEL Classification: E31, E42, E52, E58

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