INTERNATIONAL JOURNAL ON HUMAN COMPUTING STUDIES
https://journals.researchparks.org/index.php/IJHCS e-ISSN: 2615-8159 | p-ISSN: 2615-1898
Volume: 04 Issue: 1 | Jan 2022

"Monetary Targeting Versus Inflation Targeting"

Boboev L Kadrkhuja
Senior lecturer, Tashkent state university of economics

Gaybnazarova Parvina, Utbasarov Oybek, Achilova Anorakhon
Second year student, Bukhara engineering technological institute

---***---

Annotation: In this article you can see to review and analyze modern approaches to monetary targeting and inflation targeting in the world through a deep and comprehensive analysis of the macroeconomic conditions for the implementation of monetary policy at the present stage, to develop proposals for improving these approaches and consider the possibility of using the results obtained in conducting and boosting monetary policy in Uzbekistan. In particular, to adapt foreign achievements to select the most effective mechanisms for the development of the inflation targeting regime in Uzbekistan, the development of measures and the formulation of proposals to ensure the effectiveness of the inflation targeting regime.

Keywords: Monetary targeting, inflation, financial system, central bank, supply and demand.

Introduction

Monetary regulation of the economy is an integral element of the macroeconomic policy of the state. One of the necessary conditions for the effective development of the economy is the formation of a clear mechanism of monetary regulation, which allows influencing business activity, aggregate demand, the state of the credit market, controlling the activities of commercial banks, and achieving stabilization of monetary circulation. Its main goals are to ensure price stability, maximum employment of the population, growth of real production, and a stable balance of payments. Monetary policy influences various macroeconomics processes, such as inflation, economic growth, and unemployment. Thus, monetary policy occupies one of the key positions in macroeconomic regulation. The relevance of the chosen topic is because in modern conditions, monetary policy in the form of an inflation targeting regime is becoming widespread, and there are more and more supporters of it, both in developed and developing countries. But, what about monetary targeting, which is gradually disappearing. Therefore, it is advisable to identify the advantages and disadvantages and problems associated with the implementation of these monetary policies.

New version of the Law "On the Central Bank of the Republic of Uzbekistan" (hence referred to as the "Law") has been passed, continuing the country's financial reform. The law expands the Central Bank of the Republic of Uzbekistan's (hence referred to as the "CB") supervisory duties and establishes additional tasks and authorities. The changes are primarily aimed at safeguarding the financial system's stability as well as the protection of customers' rights and interests, resulting in stricter requirements for banks. The Law, in general, consolidates the CB's rights and duties, which were recently increased by the laws "On Banks and Banking Activity" and "On Payments and Payment Systems." The President of the Republic of Uzbekistan's Decree No. UP-5877 dated November 18, 2019, on "Development of Monetary Credit Policy by Gradual Transition to the Inflation Targeting Regime" (hereinafter referred to as the "Decree") approved the gradual transition to inflation targeting in order to reduce and maintain the level of inflation at 5% by 2023. Monetary targeting and inflation targeting were compared and it was found that inflation targeting is a more effective way of monetary policy if we compare it with monetary targeting. The reason for this is the lack of correlation

INTERNATIONAL JOURNAL ON HUMAN COMPUTING STUDIES
https://journals.researchparks.org/index.php/IJHCS e-ISSN: 2615-8159 | p-ISSN: 2615-1898
Volume: 04 Issue: 1 | Jan 2022

between inflation and monetary aggregates, which are tools of monetary targeting. However, it is still believed that monetary targeting works well in developing countries, so this kind of monetary policy still exist in some countries.

Literature Review

Since the mid-1970s, Germany's experience with inflation targeting has been analyzed by Juergen von Hagen. The premise for monetary targeting is inflation targeting, although the inflation objective takes precedence over the monetary aim. He created a model of Germany's equilibrium price level and demonstrated that the Bundesbank acted as if it was pursuing a price level rather than an inflation objective on many occasions. This could be owing to the actual price level's sluggish adjustment to the equilibrium price level. [1]

The experience of monetary policy techniques that use monetary or inflation targets in several industrialized countries is described in this study. The experience of monetary targeting implies that, while it was effective in managing inflation in Switzerland and Germany, the unique conditions that made it succeed in those two nations are unlikely to be met elsewhere. For countries that opt to have an autonomous domestic monetary policy, inflation targeting should lead to greater economic performance. [2]

They provided empirical information on the expected size of control and indicator issues associated with various monetary targets and a direct inflation target. The Kalman filter was used to estimate the relationships between monetary policy measures and inflation in dynamic linear models. They used German data from the end of the Bretton Woods system through 1997 to examine potential intermediate- and final-target monetary policies. The findings of the estimations reveal that broad money outperforms narrow money as an intermediate objective and that the control challenges associated with targeting broad money are worse than those associated with direct inflation targets. [3]

Using cointegration and structural vector autoregression (SVAR) techniques this paper investigates the effect of Bank Indonesia's (BI) monetary policy on inflation during the post-1997 crisis monetary-targeting period. His analysis suggests that BI's monetary policy does not have a systematic impact on the price level, apparently because of unstable money demand. Unreliable effects of BI's monetary policy are reflected in frequent and substantial deviations of the actual inflation rate from its targeted ranges. [5]

They investigated the relative performance of monetary inflation targeting using a small empirical model of inflation, output, and money based on US data. The findings suggest that monetary targeting is ineffective, resulting in higher inflation and output variability. Even with a nonstochastic money demand formulation, this is true. Their findings were likewise unaffected by the use of a P model of inflation. As a result, there is little support in these popular frameworks for the Eurosystem's monetary policy plan giving money growth a key role. [6]

Since the 1980s, Ghana's central bank (BoG) has used monetary aggregates and inflation targeting to assure increased production growth, low unemployment, and stable, low inflation. Between 2007 and 2015, the inflation rate averaged 13.26% per year under inflation targeting, compared to 29.22% per year with monetary aggregates targeting. Despite the decreased inflation rates, an average inflation rate of 13.2 per cent per year is significantly higher than the medium-term aim of 8%. The effectiveness of monetary aggregates targeting and inflation targeting in managing inflation at moderate levels was investigated in this research. The data was analyzed using the autoregressive distributed lag (ARDL) model, which covered the years 1970–2015. The findings reveal that monetary targeting has only moderated inflation in the short run, whereas inflation targeting has kept inflation rates low in the medium and long run. However, given the slow transmission of broad money supply and prime rate adjustments to inflation, neither system has been able to keep inflation steady and within the target band. They urge Ghana's monetary authorities to improve the institutional

INTERNATIONAL JOURNAL ON HUMAN COMPUTING STUDIES
https://journals.researchparks.org/index.php/IJHCS e-ISSN: 2615-8159 | p-ISSN: 2615-1898
Volume: 04 Issue: 1 | Jan 2022

framework for controlling short-term interest rates. They should also improve the Bank of England Act of 2002 (Act 612), which establishes secondary anchors and norms for output, money supply, and fiscal deficit. Finally, the monetary policy committee should improve its communication mechanism to increase monetary policy credibility and transparency. [7]

Bakare looked into the factors that influence money supply increase and how it affects inflation in Nigeria. It was discovered that a 1% increase in money supply resulted in a 5.6 per cent increase in the stated inflation rate. The result related to the tight control of the money supply and circulation (velocity) in Nigeria, which resulted in significant inflation.

Using time series data attributes, Chaudhry et al. (2012) investigated the connection between monetary policy, inflation, and growth in Pakistan from 1972 to 2010. The findings show that loans to the private sector, financial depth, real exchange rate, and budget deficit are all elastic and significant variables that influence Pakistan's real GDP. The results of pair-wise Granger causality imply that real GDP and real exchange rate cause each other in a bi-directional manner. Financial depth, domestic credit, and the budget deficit are all caused unidirectionally by real GDP. The financial depth and budget deficit variables are also influenced by the real exchange rate.

Methodology

In this article, the advantages and disadvantages of the monetary and inflation targeting regimes implemented by the central banks were compared by using different qualitative and quantitative from several websites. A large scope of sources such as research papers and websites, which provided us with official and relevant information (cbu.uz) were used. The works of various authors were investigated and their points of view towards our topic were summed up and summarized. The main theoretical and methodological aspects of this work are reflected in the works of foreign economists who laid the theoretical foundations and practical ways to introduce the regime of inflation and monetary targeting. The most fundamental works include the works of such authors as B.Bernanke, F.Giavazzi, C.Goodhart, B.Delaunay, L.Svensson, K.Sims, D.Tobin, T.Walsh and W.Sharp.

Results and Analysis

When implementing the monetary targeting regime, the central bank sets targets for the growth of the money supply and manages their achievement. Monetary aggregates (mainly M1 and M2) act as an intermediate objective of monetary regulation. Several conditions are necessary for the successful operation of the monetary targeting regime:

The central bank, by managing monetary aggregates, influences key macroeconomic indicators (inflation, unemployment, economic growth).

Monetary authorities publicly announce targets for the growth of money supply, assuming soft commitments to achieve them.

The monetary authorities have at their disposal a sufficient set of tools to manage the money supply.

This regime was used in most developed countries after the collapse of the Bretton Woods system in 1973 and was popular there for about 20 years. The reference countries for the application of the monetary targeting regime were Germany and Switzerland. In Germany, there was not just the approval of growth rates for the cash supply, but also the targeting of broad monetary aggregates, and this policy continued until the creation of the Eurozone in 1999. However, countries with developed monetary regimes (targeting M2, M3, and M4 aggregates) quickly encountered their negative side effects: the impact on economic growth rates, the exchange rate, and the state of the financial market, which forced them to periodically adjust previously approved benchmarks.

Due to the negative consequences of the monetary targeting regime in the 90s, many developed countries began to abandon it. So, in the UK, since 1982, only the growth rate of the M0 unit has been legislatively established. Japan moved away from tight monetary targeting in 1992.

Meanwhile, in the 90s, the monetary targeting regime turned into a standard recommendation of the International Monetary Fund and several independent researchers for countries with economies in transition and emerging markets at the first stages of market transformation.

Table 1. The mechanism of monetary targeting

	Advantages	Disadvantages
1.	Monetary policy autonomy: the central bank focuses its efforts on the realization of the internal interests of the national economy;	The absence of a stable and predictable link between the intermediate objectives of monetary regulation and inflation;
2.	Predictability and transparency of the central bank's actions;	Weak control of broad monetary aggregates by the monetary authorities;
3.	A partial solution to the problem of time-inconsistent monetary policy;	Low responsibility of the monetary authority to the society to achieve the targets;
4.	High controllability of monetary aggregates M0 and M1;	Weak information efficiency.
5.	Ease of implementation;	
6.	A simple form of accountability of monetary authorities.	

Since the money supply and inflation showed a high degree of correlation, the further choice was made in favour of inflation targeting, with the help of which it is supposed to solve not only the issues of the value of money and price stability but also ensure employment and balanced economic growth. [8]
The inflation targeting regime appeared in the late 80s and was rapidly developed in the following decade as an alternative to monetary targeting. This regime is very demanding on the institutional and macroeconomic environment. The creation of conditions corresponding to the inflation targeting regime determines the expansion of investment opportunities in the market. Inflation targeting is carried out by countries that indicate inflation indicators and strive to achieve them.

Table 2. The mechanism of inflation targeting

	Advantages	Disadvantages
1.	It helps to strengthen confidence in monetary regulation and limit inflation expectations.	Restricts the freedom of action of the regulator and therefore unnecessarily restrains economic growth.
2.	Provides greater flexibility of monetary regulation.	Unable to limit expectations because it represents too much freedom of action.
3.	Allows the reduction of economic costs in case of failures of monetary regulation.	Inflation is difficult to predict and control. Assumes high volatility of the exchange rate.
4.	Copes with supply and demand shocks. In	It cannot be effective in countries that do

	the event of a demand shock, inflation targeting fully compensates for it, the price level and output return to their equivalent indicators. This is because monetary authorities can directly influence demand by regulating the money supply.	not have a set of necessary conditions: the technical capabilities of monetary authorities, the underdevelopment of the financial market, an effective institutional structure that supports and stimulates low inflation, the lack of subordination of monetary policy to fiscal policy.

The policy of inflation targeting in almost all countries has proved its effectiveness at the first stage. There was a significant decrease in the rate of inflation, and this drop was significantly higher than in other developed countries with similar characteristics of the economic system. [9]

In the 1970s and 1980s, New Zealand observed very high inflation. It was about 10-20% per year. The main reason for the lack of price stability was government spending, supported by a weak monetary policy. The Reserve Bank of New Zealand was not operationally independent from the government. Although the elected government promised to reduce inflation, it didn't want to face the short-term costs of disinflation (a fall in demand and negative economic growth). Inflation expectations remained high – as did actual inflation.

In 1986, the Minister of Finance invited officials to reform the monetary policy framework. The main objective was to reduce the scope of political influence.

As a result, in 1989 the Reserve Bank Act was formed. It presented 4 ideas for supporting price stability:

Providing the Reserve Bank with operational independence: protected the Reserve Bank from government pressure. Moreover, now they could create conditions that were necessary to reduce inflation and anchor expectations at low levels.

Pursuing a single objective of price stability: before 1989 along with price stability, the monetary policy was concerned with production, trade and unemployment. Focusing only on price stability increased the belief that the Reserve Bank could keep its promise to achieve the goal.

Giving the Governor authority to act as a single decision-maker: the legislation declared that the Governor of RBNZ could lose his job if the inflation target, announced by the Policy Targets Agreement (range of 0 to 2% by 1992), would not be achieved. This action increased the credibility of the public since he would have to reduce inflation if he wanted to keep his position.

Reserve bank should provide transparency: the decisions of the Governor would be monitored and assessed by the Board of Directors appointed by the Minister of Finance. Furthermore, the public had access to the published Governors suggestions and the Board's Annual Report on monetary policy decisions - this gave the stockholders the ability to estimate the rationality of the Governor's decisions. [10]

Together, these four ideas made it possible for the Reserve Bank to conduct a credible disinflationary monetary policy. Consequently, by an aggressive monetary tightening campaign, the Reserve succeeded to reduce inflation from 19% in 1988 to 2% by 1991. They managed to reach the target one year early. The public's expectations immediately settled as they realized the strong intentions of the Governor. Besides the advantages, monetary tightening caused some significant disadvantages to the economy of New Zealand. Real GDP was stagnant between 1989 and 1994, unemployment peaked. The Reserve Bank's target for price stability was expressed as the Consumer Price Index (CPI) inflation, which initially included house prices and mortgage-servicing costs. To create public support for low inflation, the Bank needed to improve its management of the short-run output-inflation trade-off. The new focus included not only maintaining the price

INTERNATIONAL JOURNAL ON HUMAN COMPUTING STUDIES
https://journals.researchparks.org/index.php/IJHCS e-ISSN: 2615-8159 | p-ISSN: 2615-1898
Volume: 04 Issue: 1 | Jan 2022

stability, but also the reduction of unnecessary volatility in the real economy. Aggressive tightening helped lower inflation to the target with some negative consequences to the economy, so now the RBNZ had to be more accurate when maintaining price stability without unnecessarily disrupting the economy. [11]

Uzbekistan has decided to change its monetary policy into inflation targeting. The choice of the inflation targeting regime in Uzbekistan is explained by a number of reasons. Firstly, inflation targeting has proven to be the most effective monetary policy regime that best meets the set goals for effectively ensuring price stability in the medium term.

Secondly, the experience of using alternative currency or monetary targeting regimes indicates that they do not meet the modern requirements and realities of Uzbekistan. For example, under the exchange rate targeting regime, the need to constantly maintain it at the target level dramatically increases the risks of reduction of international reserves and the occurrence of currency crises.

Moreover, the decrease in the stable relationship between monetary aggregates and the inflation rate makes the use of monetary targeting unpromising. The steps taken to liberalize monetary policy, as well as a clear definition of priorities to ensure price stability, create the basic prerequisites for the transition to inflation targeting.

The interest rate channel is a traditional channel for transmitting the impact of monetary policy measures on the economy. The change in the central bank's interest rate affects the level of interest rates in the economy as a whole, which leads to corresponding changes in investments/savings and, consequently, in aggregate demand. Changes in the volume of demand, in turn, affect inflation.

The credit channel is one of the main channels of monetary policy transmission, through which interest rates influence the processes in the real sector of the economy. The effectiveness of this channel is largely due to the sensitivity of the supply and demand of credit resources to increase or decrease the interest rate of the Central Bank. In the second half of 2017, the Central Bank tightened monetary conditions by raising the refinancing rate to 14%, which led to a corresponding increase in interest rates on credit resources. Exchange rate channel. The transfer of influence through this channel occurs when a change in the conditions of monetary policy (towards tightening or easing) leads to a change in the exchange rate, affecting the relative demand for domestic and foreign goods and services. The channel of inflationary expectations is based on the fact that when making their decisions, participants in economic processes not only take into account real market conditions but also their likely future change. For example, inflation expectations are important for entrepreneurs and organizations when setting prices and assessing wage dynamics in the future. The asset price channel has an impact on the inflation rate due to the influence of monetary policy conditions on asset prices. In particular, with the effective functioning of this channel, a decrease in the interest rate on government debt obligations due to the easing of monetary conditions leads to the redirection of financial resources to more attractive alternative assets. As a result, there is an increase in the value of alternative assets and, accordingly, the price level. Currently, the aim of the Central Bank in Uzbekistan is to ensure price stability and financial stability in the economy, reducing inflation to 5% by the end of 2023. Prices of products that are exported from Uzbekistan have been rising, so it is predicted that the volume of exports (without gold) will grow by 20-25% in 2022 and 15-22% in 2023-2024. According to forecasts, imports will grow by 10-12% in 2022, by 13-17% in 2023 and by 9-10% in 2024. Inflation rate projected at 8-9% in 2022, inflation is expected to fall to a target level of around 5% in 2023-2024. [12]

Conclusion

Based on all of the above-mentioned factors, it can be seen that inflation targeting has much more advantages over monetary targeting (Stable inflation reduces investor uncertainty, allows investors to predict changes in

INTERNATIONAL JOURNAL ON HUMAN COMPUTING STUDIES
https://journals.researchparks.org/index.php/IJHCS e-ISSN: 2615-8159 | p-ISSN: 2615-1898
Volume: 04 Issue: 1 | Jan 2022

interest rates, and anchors inflation expectations. If the target is published, inflation targeting also allows for greater transparency in monetary policy.). In this regard, inflation targeting is recommended more for its introduction into the monetary policy of Uzbekistan. Moreover, it is already being implemented. The main reason for implementing inflation targeting is the pressing need to take additional decisive steps to reduce inflation, given the rising risks of the current two-digit inflation rate persisting as a result of ongoing structural reforms, such as price liberalization and tax reforms.

1. Actions that are going to be taken to improve monetary policy in Uzbekistan:
2. In determining the exchange rate, the existing method fixing has been changed to a continuous trading method ("Matching").
3. Introduced a daily definition of the official exchange rate of the Central Bank.
4. Currency transactions are brought in line with international standards
5. Commercial banks were given the opportunity to trade freely on the domestic foreign exchange market.
6. Increased activity of the interbank money market.

References:

1. Juergen von Hagen "Inflation and Monetary Targeting in Germany", 1995;
2. Frederic S. Mishkin, "From Monetary Targeting to Inflation Targeting (Lessons from Industrialized Countries)", 2001;
3. Karen Cabos, Michael Funke and Nikolaus A. Siegfried, "Some Thoughts on Monetary Targeting vs. Inflation Targeting", From the journal German Economic Review, 2003;
4. Akihiro Kubo, "Monetary targeting and inflation: Evidence from Indonesia's post-crisis experience," Economics Bulletin, AccessEcon, vol. 29(3), 2009, pages 1805-1813;
5. Glenn D. Rudebusch, Lars E.O. Svensson, "Eurosystem monetary targeting and inflation targeting: Lessons from U.S. data", 2001;
6. Mohammed A. Abango, Hadrat Yusif, Adam Issifu, "Monetary Targeting, Inflation Targeting and Inflation Stabilization in Ghana", 2019;
7. Bakare (2011), Chaudhry et al. (2012), "Monetary targeting versus inflation targeting in Pakistan".
8. https://cbu.uz/en/press_center/releases/541846/
9. https://www.uzdaily.uz/en/post/67038
10. http://www.publicnow.com/view/A47161EA3D14F2BE3F09E5EA327DA0236E2DE753
11. https://en.trend.az/casia/uzbekistan/3462535.html
12. https://studme.org/351787/finansy/rezhimy_targetirovaniya_denezhno_kreditnoy_politike