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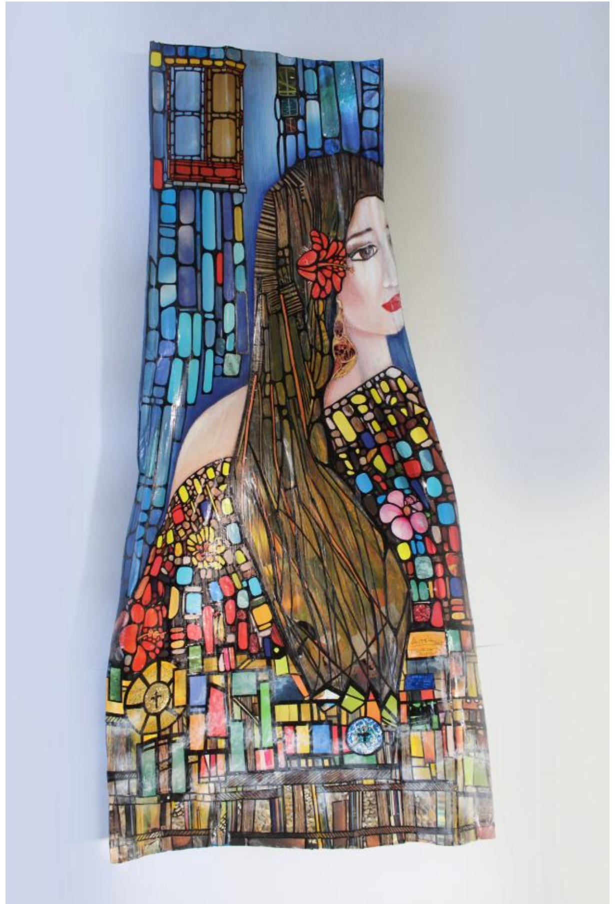

Universidad del Zulia

Facultad Experimental de Ciencias

Departamento de Ciencias Humanas

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Effectiveness of inflation targeting based monetary policy

Saad Salih Issa
College of Administration & Economic Branch of Economic, TIKRIT University
saadalissa2001@tu.edu.iq

Hameed Hasan Khalaf
College of Administration & Economic Branch of Economic, TIKRIT University
hameed.h.k@tu.edu.iq

Ahmed Rashid Almuain
College of Science, TIKRIT University
ahmedaltaaey80@tu.edu.iq

Essia Ries Ahmed
Graduate School of Business, Universiti Sains Malaysia
essia@usm.my

Abstract

In this research, the performance of inflation targeting strategy was analyzed using the ordinary least square method (OLS) with the regression model for economic circumstances in Britain. The results of this investigation concluded that net lending ratio and total debt to GDP ratios have a positive and strong relationship with the inflation rate. It is concluded that the implementation of the inflation targeting policy has an impact on the economic performance in Britain. However, a proper monitoring and investigation of the current economic state are necessary before implementing inflation targeting policy.

Keywords: Inflation, Central Bank, Inflation Targeting.

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La efectividad de la inflación basada en metas de política monetaria

Resumen

En esta investigación, se analizó el desempeño de la estrategia de metas de inflación utilizando el método de mínimos cuadrados ordinarios (MCO) con el modelo de regresión para las circunstancias económicas en Gran Bretaña. Los resultados de esta investigación concluyeron que la proporción de préstamos netos y la relación deuda total / PIB tienen una relación positiva y fuerte con la tasa de inflación. Se concluye que la implementación de la política de metas de inflación tiene un impacto en el desempeño económico en Gran Bretaña. Sin embargo, es necesario un adecuado monitoreo e investigación del estado económico actual antes de implementar la política de metas de inflación.

Palabras clave: inflación, banco central, metas de inflación.

1. INTRODUCTION

The dilemma of inflation is not the result of the modern era, but it is all the economic systems of different ages and did not distinguish between developed or developing countries. It has serious effects on economic development, such as reducing savings and lessens investments, thus reducing the rates of economic growth. Since the 1980s, monetary policy has been characterized by many changes due to the large and unprecedented rise in inflation rates. The policies applied at that time were no longer widely accepted because of their failure to rein in inflation (Abdel, 2012). Therefore,

reforms were concerned with a new approach of monetary policies to effectively addressing the underlying causes of inflation. Ineffectiveness of other frameworks in achieving the ultimate goal, inflation targeting monetary policy came as a framework for managing inflation.

Integration between financial markets and global trade has increasingly pushed changes in monetary policy regimes. Adopting a flexible and not a fixed exchange system and the resulting increase in the possibility of higher external inflation rates have made the policy of inflation targeting the most appropriate policy to cope with critical fluctuations and changes (Abdel, 2012). A global agreement on the threat of high inflation rates because of negative effects on growth and income distribution create the need for a new monetary policy. The instability of the relationship between money supply and inflation, which creates a problem of monetary policy targeting the money supply as the policy does not provide the central bank enough signals about monetary policy. Therefore, failed to stabilize the expected inflation rates (Eser, 2002). Consequently, the emergence of the idea for autonomous central banks in managing monetary policy to achieve the goal of price stability had begun.

The policy of inflation targeting appears to be popular since the 1990s. Central banks find themselves forced to stabilize prices to ensure slow rates of change in prices. The indirect methods to control inflation such as exchange rate and total monetary failed to produce desirable results. Therefore, a modern method of monetary policy

management based on a direct approach to reducing inflation and price stability has been adopted by many countries around the globe (Alshennawi, 2014). This research aimed to understand and investigate the effectiveness of new inflation targeting policy to achieve its objectives. A case study of the British Central Bank and its implementation of inflation targeting policy have been targeted in this study.

2. LITERATURE REVIEW

Inflation targeting is not a method or instrument to reduce the current rate of inflation, but it is a policy of controlling price stability (Eser, 2002). It is a system that has the explicit quantifiable inflation target by determining the indicator, the target level, the area of change, the time horizon, and the definition of possible situations that allow the monetary authorities to change the target. Consequently, Inflation targeting policy is defined as a framework for monetary policy through which the central bank can ensure low inflation. This procedure makes it possible to declare inflation expectations early, as well as the design of measures to control prices. Generally, targeting inflation requires the central bank a minimum of independence and the establishment of an appropriate system for analysis and forecasting. (Idris, 2008).

Inflation targeting policy t has no intermediate objective, but inflation is targeted directly. This objective is achieved through three steps:

- First, determine the monetary policy to achieve the target inflation rate,

- The second should predict the central bank rate of inflation in the future,

- The third is to compare the target rate to the expected. If the forecast is higher than the target, a contractionary monetary policy is followed and vice versa (Hussein, 2010).

2.1 The Emergence of Inflation Targeting Policy

The first inflation targeting experiments began as a monetary policy management system started in Finland in December 1989, then in Canada in 1991 and then in the United Kingdom in 1992, followed by other industrialized countries such as Australia and Sweden 1993. Later on, the realization of low and stable inflation rates encouraged a number of developing countries to adopt such policies. Since the mid-1980s, the central banks of the industrialized countries have faced the problem of the failure of intermediate targets such as the exchange rate and monetary aggregates to achieve the objectives of monetary policy. Since the beginning of the seventies many economists have tended to support the effective role of monetary policy in controlling inflation, maintaining a high level of economic growth and reducing unemployment based on Phillips' idea of a positive correlation between inflation and unemployment in the long term. The economic

policymakers' belief was that monetary policy was accompanied by a certain rise in inflation while maintaining a low level of unemployment and an increase in the level of GDP. However, the economic effects of these expansionary monetary policies during the 1970s and 1980s resulted in a significant rise in inflation and a decline in economic growth rate and rising unemployment (Care, 2011). In these circumstances, it was ascertained that the goal of price stability was the priority of monetary policy to achieve sustainable economic growth in the long term. Hence, the emergence of the idea for autonomous central banks in managing monetary policy to achieve the goal of price stability had begun.

2.2 The fundamental conditions for targeting inflation

2.2.1 Independence of the Central Bank

Central Bank independence means giving autonomy for monetary policy to effectively achieve their goals by freely adjusting monetary instruments. At the same time, there should be no direct public sector financing by the Bank. Government revenues must be sufficient to cover government expenditures. (That privilege differs from one country to another). The independence of central banks is an important issue in the search for an institutional framework that helps monetary policy to keep inflation at low levels in the medium and long term. Independence means the freedom of the central bank to formulate and implement monetary policy without political

considerations or interference in any way. Only with an absolute separation between the central bank and the government, the Bank alone is the one that determines the final objectives of monetary policy. Therefore, the Bank is looking for independence in determining intermediate objectives and in adopting the appropriate tools to achieve these objectives. The credibility of the central bank is meant to take the necessary measures to achieve the objectives of monetary policy, and undoubtedly that the acquisition of the Central Bank of credibility makes the events that are affected by his decisions moving in the direction required faster. The independence of the Central Bank is an important pillar for implementing a more effective monetary policy and accelerating the achievement of the objectives, which enhances its credibility (Care, 2011).

In general, close interdependence between the independence of the central bank and the credibility of the performance of monetary policy can be achieved through the development of laws and regulations in a transparent manner (Mohamed, 2013). The implicit independence of the Central Bank implies that the government is not funded by monetary expansion in order to fill the budget deficit. Moreover, the public sector does not receive the necessary financing directly or at low interest rates, so that there is no discrimination that gives the public sector a preference compared to the private sector (Eroğlu, 2009). A certain nominal exchange rate or an increase in the economic growth rate in a way that is inconsistent with long-term stability of prices. The lack of availability of the above conditions is sufficient proof of the weakness of the effectiveness of monetary

policy and its inability to implement the inflation targeting policy because the central bank finds itself incapable of fulfilling its declared targets (Anzo, 2015). Thus becomes forced to adapt monetary policy to suit the prevailing conditions, and confirms some economists that the state, which has inflation rate ranges between 8-15% for a period of 3-5 years is not unreasonable to pursue a policy aimed at reducing the rate of inflation continuously (Gug, 2009).

2.2.2 Stability and Development of the Financial Sector

The weakness of the banking system and the growing problem of bad loans play a role in restricting the ability of the central bank to move forward. The central bank should intensify the efforts to better manage the exchange rate to reduce the negative effects that may affect the local currency. The flexibility and depth of the financial sector is critical to the sound and effective application of the inflation targeting policy. The strength of the financial market is central to the central bank, especially as it applies open market policy. It is in dire need of setting interest rates based on market forces (Ghazi, 2016).

2.2.3 The Motives for Using Inflation Targeting Policy

The increased contribution of integration in the global financial and trade markets stimulates the changes in monetary policy regimes

due to a great shift in the adoption of a flexible rather than a fixed exchange system. There has been a global agreement on the seriousness of high inflation rates, which have a negative impact on growth and fairness of income distribution and through the adoption of inflation targeting policy is expected to reduce this risk, and achieve low inflation to raise the economic performance of the country. Furthermore, the inflation targeting framework is the core of reducing the budget deficit. Many of the countries that are implementing the inflation targeting policy have managed to reduce their budget deficit and achieved a surplus, as is the case with Turkey, Brazil, and Mexico. The inflation target countries seem to have been able to reduce the inflationary wave of rising commodity prices in a year as the price shock has led to higher inflation and lower growth in most of the world. However, the degree of intensity of these effects has been less pronounced on countries that pursue inflation targeting. This result is consistent with the idea that inflation expectations are better entrenched in inflation target countries, and the monetary authorities are working harder to prevent inflation.

2.3 Benefits of Applying Inflation Targeting Policy

We can enumerate the advantages of the targeting inflation policy from the diverse examples of developed and developing countries, where these countries have succeeded in achieving positive benefits. It is evident that, access to and maintenance of a low and stable inflation rate in the long term, leading to significant impacts on

economic growth. Most of the countries that have reduced short-term inflation rates and maintained long-term price stability have helped them to achieve economic growth and employment significantly than before the introduction of the inflation targeting policy. Despite the low rate of economic growth in the short term due to the adoption of a contractionary monetary policy, the rate rises in the long term, and the use of inflation allows the possibility of increasing national income and reducing unemployment rates rather than targeting a specific rate (Abdulhamid, 2016). The policy of inflation targeting helps to avoid large fluctuations in national income due to increased confidence in the expectations of the public and market customers for inflation in the future so inflation targeting can be considered beneficial to the real economy to stimulate growth and reduce the fluctuations in income (Eroğlu, 2009). The degree of certainty regarding the stability of the relationship between the level of prices and wages in the future will be more assured in the long term economic stability than in the case of monetary aggregates or the exchange rate, which will make the inflationary expectations more coordinated and more accurate. The monetary authority can face the shocks to both demand and supply macro-economic activity and focus on real economic variables such as growth rate and the level of employment because targeting inflation provides greater freedom of monetary authority in the face of cyclical fluctuations in economic activity.

The inflation targeting system gives better periodic adjustments to the economy because it leaves an important area for the application of monetary policy directions and enables the central bank to be more

flexible in dealing with supply and demand shocks. This method of monetary policy management does not require a frequent adjustment of intermediate targeting as it focuses directly on a quantitative target or extent of inflation. In the case of targeting of monetary aggregates, it may need to be adjusted periodically due to changes in the demand function of cash resulting in changes in the relationship between supply growth and price stability targets which makes these targets poor indicators of monetary policy performance. The instability of the relationship between exchange rate targeting and monetary aggregates corresponds to the elasticity of these variables in the context of inflation targeting. Therefore, monetary policy can adjust to the temporary increase in the inflation rate, which does not affect the achievement of the target rate. Targeting inflation is the catalyst for institutional change by giving the central bank greater autonomy by reducing political pressure on it, thus enabling it to achieve the goal of price stability by focusing on a clear rate or range of inflation. Creating transparency, certainty and greater understanding among all market clients of monetary policy directions leads to credibility in the central bank and its ability to meet its obligations. Further, inflation targeting system provides the ability to reduce the occurrence of the central bank in the problem of time lags of monetary policy resulting from political pressures to expand the supply of cash.

Using the inflation targeting policy as a measure or criterion for the effectiveness of monetary policy is more objective than using conventional monetary policy. This policy makes it possible to compare the gap between the inflation rate achieved and the target. So

that, future monetary policy directions can be predicted in terms of flexibility or firmness in achieving their object (Ghazi, 2016). Increased transparency and accountability as inflation targeting targets more credible monetary policy effectiveness in achieving long-term price stability, resulting in increased economic growth and employment. This is not to say that this policy is not subject to special criticism regarding the fluctuations in national income and the lack of continuity between the monetary instruments and inflation (Eser, 2009).

2.4 Criticism of Inflation Targeting Policy

Eser (2009) argues that there is no guarantee that the central bank will be successful in using its discretion to develop appropriate monetary policy as opposed to targeting monetary aggregates or the exchange rate. Inflation targeting is complex in its application. Ghazi (2016) Inflation targeting, contrary to exchange rate targeting, is that it may be difficult for the monetary authority to control the inflation rate due to relatively long periods of delay in the inflation forecasting operations. Therefore, a deviation in the inflation rate may result from the target rate set by the Central Bank for Monetary Policy Management. The nature of the future targeting of inflation requires the central bank to take into account the possibility of delay between monetary policy changes and their effects on inflation. Monetary authority must be able to respond to deviations in specific time horizons by establishing a stable relationship between policy

instruments, Cash and an effective model of inflation expectations targets. The central bank's expectations must be accurate and rational to make the deviations as little as possible (Idris, 2008). Inflation targeting cannot be the only framework that improves the instrument of central banks for their objectives. Several countries have managed to reduce inflation and maintained long-term price stability, such as Germany and the European Union without using inflation targeting policy.

Inflation targeting allows too many estimates. Increased expectations increase income instability, reduce economic growth, especially in the short term, weaken the central bank's responsibility to control inflation as a result of the lack of direct correlation between its instruments and an inflation target. Similarly, the elasticity of the exchange rate required by inflation targeting policy causes financial instability. Exchange rate fluctuations cannot be avoided, especially if they are large and unpredictable. It is impossible to ignore the management of exchange rates under inflation targeting. Developing countries face the problem of widening deviations from the target rate due to repeated large errors in the inflationary expectations. The inevitable outcome will create difficulties for Central Banks in clarifying the reasons for deviations from the target, which reduces its credibility (Frederic, 2002). Focusing on a specific digital rate reduces the ability and flexibility of the central bank to implement its monetary policy in dealing with internal and external shocks. The central bank is responsible for creating economic stability on the one hand and for providing the necessary liquidity for economic activity and creating

stable financial markets that are capable of achieving full employment of economic resources and high growth rates and reducing fluctuations in the level of GDP. However, these criticisms will not diminish this policy in the long term if they are well implemented by respecting the basic conditions and general conditions.

2.5 Targeting Inflation Monetary Policy Framework

Monetary policy is one of the most important economic policies that are used to achieve economic objectives aimed at stabilizing the situation in general. The central bank is responsible for this process by introducing changes in the money supply to suit the conditions in the country. It is the set of measures adopted by the Central Bank to effect a change in the quantity of money and liquidity in the society to achieve stability in the general level of prices or other economic objectives that have a social impact. Monetary policy is to affect economic activity and reduce fluctuations in the economic cycle, fiscal policy and the problem of public debt (Akram, 2015). It is clear that monetary policy aims at clarifying the status and monetary situation of the state to achieve economic stability and solving problems that exist or are likely to occur through the Central Bank. The means used are either through intervention in the money market to influence the creation of money or through direct supervision of interest rates and loans. As there are different objectives for monetary policy, there are intermediate objectives (which are directly monitored as interest rates

and monetary reserves), which we seek to reach the economic goals (Ben, 2016).

2.5.1 Tools of Monetary Policy in targeting inflation

- The open market: The central bank should sell securities (bonds and shares) to get their value and reduce the money supply and reduce borrowing to control inflation (Abdulhamid, 2016).

- Legal Reserve Ratio: The reserve ratio is raised on commercial banks to achieve an appropriate rate, which is kept by the Central Bank. Thus, reducing the chances of borrowing from them for a period of time to reduce the liquidity of banks, which gives individuals freezing some of their monetary reserves to alleviate inflation?

- Discount rate and interest rate: The discount rate represents interest on banks borrowed from the Central Bank. The interest rate will be on the customers of banks, by raising the discount rate to reduce the borrowing of banks from the Central Bank, thus raising the interest rate that reduces the borrowing of individuals to reduce liquidity and increase total spending by consensus with the open market, but we find that these policies prove failure to reduce the volume of credit or achieve the desired goal (Hussein, 2010).

• Encourage investment by reducing the cost of financing by aligning the interest rate with the sector conditions to be financed and allocating credit by setting a ceiling on the loan term grants (Akram, 2015).

• Prior approval of some types and amounts of long-term loans, change the maturity of loans granted and interest rate for some sectors.

• The freedom of commercial banks to replace certain percentages of the legal reserve with certain types of loans, investments, and other instruments with a high degree of flexibility (Ben, 2016).

• Literary persuasion: by directing banks' policies and warnings to restrict the central bank's policy and raise interest rates to rebalance.

• Direct instructions required: It is mandatory where banks adhere to the policy of the Central Banks.

• Media: Explain the facts to citizens to help achieve economic balance.

2.6 The British Central Bank Case Study

The United Kingdom experienced the most volatile and high inflation during the 1970s and 1980s, before the onset of inflation targeting .The United Kingdom adopted inflation targeting policy in October 1992 after exiting the European Exchange Rate Mechanism. Initially, a target range of 1% – 4% was set based on the Retail Price Index (excluding mortgage interest rate payments). The central bank was not given full independence measure and the target was switched to 2.5% when the Bank of England was given operational independence in May 1997. The decision on interest rates was delegated by the Chancellor of the Exchequer to the Bank's Monetary Policy Committee (MPC). In December 2003, a new inflation target of 2% was set based on the Consumer Price Index (CPI) measure.

Over the last 24 years or so, inflation targeting has become an important tool for monetary policy. It has been suggested that the significant reduction both in the level of inflation as well as inflation variability observed is related to inflation targeting. Successfully taming inflation depends on the quality of the institutional framework within which central banks operates. Official data show that the United Kingdom ranks seventh in the world in terms of government effectiveness (which captures the quality of public services, the quality of the civil service and the degree of independence of political service) and the fifth (in terms of organizational quality) which highlights the government's ability to formulate and implement sound policies and regulations that promote private sector development.

The low Inflation rate in early 2015, helping the Bank of England avoids raising interest rates. But the high rate of inflation at the end of the year 2015 following the EU withdrawal referendum led to an increase in car and food fuel prices as well as higher raw material prices. Which led to a rise in the value of imports, especially for oil and food materials, pushing the wholesale prices of manufactured materials to rise? The British central bank decided to raise the interest rate if the inflation rate is 3% and switch to tightening monetary policy. The UK experience is one of the successful experiences that has revealed many positives for the inflation targeting policy and is an encouraging experience for emerging markets. This is due to the country's success in keeping inflation within the target range and thus improving its credibility and enabling it to contain inflation expectations, reducing the need for deflationary policies.

3. METHODOLOGY

This study focused on the effectiveness of inflation targeted policy to analyze the hypothecation that inflations targeting significantly affects the economic performance. The economic condition is improved with the use of inflation targeting policy in the United Kingdom perspective. Hence, the present study is conducted to analyze the impact of inflation targeting policy during and after the period of the Global Financial Crisis. Whereas, a common notion is that after the Global Financial Crisis the effectiveness of inflation targeting strategy has declined. The analysis included inflation rate,

interest rate, unemployment rate, the growth rate of GDP, the net lending ratio of GDP, GDP gap ratio, a total debt ratio of GDP Domestic, the current account balance of GDP, investment ratio of GDP, saving ratio of GDP. Multiple linear regressions were applied to record the impact of inflation on different economic indicators (Ball & Sheridan, 2003). Ordinary Least Square method is a good tool to predict linear relationship among variables. However, this study has a methodological advantage over previous investigations by adopting sophisticated technique as compared to previously using descriptive analysis only. The sample data is collected form IMF official database consisting of the time period from 2003 to 2016.

4. RESULTS AND DISCUSSION

Table 1 shows that the variables of economic activity in Britain included inflation rate, interest rate, unemployment rate, growth rate of GDP, net lending ratio of GDP, GDP gap ratio, total debt ratio of GDP Domestic, current account balance of GDP, investment ratio of GDP, saving ratio of GDP. The annual rate of change for these variables during the study period (2003-2016) was 1.2, 5.3, 0.7, 5.2, 6.3, 1.4, 8.8, 0.2, 1.2 and 3%, respectively.

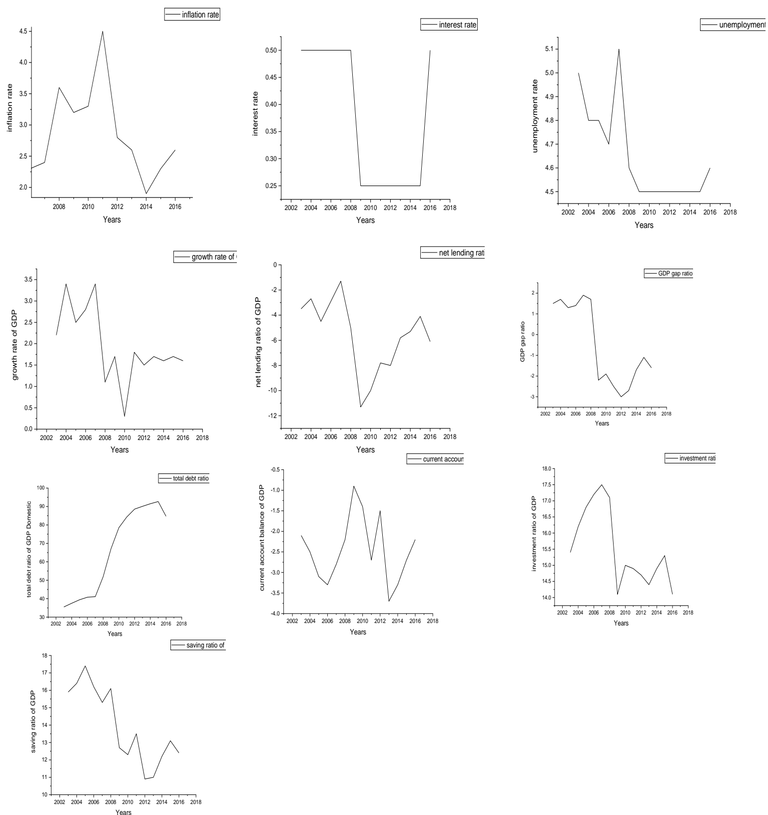
Table 1: Descriptive Statistics

Years	inflation rate %	interest rate %	unemployment rate %	growth rate of GDP %	net lending ratio of GDP %	GDP gap ratio %	total debt ratio of GDP Domestic %	current account balance of GDP %	investment ratio of GDP %	saving ratio of GDP %
2003	2	0.5	5	2.2	(3.5)	1.5	35.5	(2.1)	15.4	15.9
2004	2.1	0.5	4.8	3.4	(2.7)	1.7	37.5	(2.5)	16.2	16.4
2005	2.2	0.5	4.8	2.5	(4.5)	1.3	39.4	(3.1)	16.8	17.4
2006	2.3	0.5	4.7	2.8	(2.9)	1.4	40.8	(3.3)	17.2	16.2
2007	2.4	0.5	5.1	3.4	(1.3)	1.9	41.1	(2.8)	17.5	15.3
2008	3.6	0.5	4.6	1.1	(5)	1.7	51.9	(2.2)	17.1	16.1
2009	3.2	0.25	4.5	1.7	(11.3)	(2.2)	67.1	(0.9)	14.1	12.7
2010	3.3	0.25	4.5	0.3	(10)	(1.9)	78.5	(1.4)	15	12.3
2011	4.5	0.25	4.5	1.8	(7.8)	(2.5)	84.3	(2.7)	14.9	13.5
2012	2.8	0.25	4.5	1.5	(8)	(3)	88.6	(1.5)	14.7	10.9
2013	2.6	0.25	4.5	1.7	(5.8)	(2.7)	90.1	(3.7)	14.4	11
2014	1.9	0.25	4.5	1.6	(5.3)	(1.7)	91.5	(3.3)	14.9	12.2
2015	2.3	0.25	4.5	1.7	(4.1)	(1.1)	92.7	(2.7)	15.3	13.1
2016	2.6	0.5	4.6	1.6	(6.1)	(1.6)	84.7	(2.2)	14.1	12.4
Average	2.7	0.375	4.65	1.95	(4.71)	(0.51)	65.98	(2.46)	15.54	13.96
Annual rate of change %	1.2	(5.3)	(0.7)	(5.2)	6.3	1.4	8.8	0.2	(1.2)	(3)

Source: Compiled and calculated from IMF data - World Economic Outlook (2003-2016)

Table 2: Regression Results

Variable	Coefficients	Sig.
Interest Rate	-0.347	0.223
Unemployment Rate	-0.450	0.093
Growth Rate Of GDP	-0.485	0.573
Net Lending Ratio Of GDP	0.579	0.021
GDP Gap Ratio	0.482	0.84
Total Debt Ratio Of GDP Domestic	0.291	0.263
Current Account Balance Of GDP	-0.359	0.350
Saving Ratio Of GDP	-0.217	0.863
Investment Ratio Of GDP	-0.159	0.027



Figue.1: Change of all the variables over the time period of 2003-2016

When examining the relationship between the variable interest rate and inflation rate in the UK during the period (2003-2016), the significance of the relationship was not significant at 0.05, indicating that there is no correlation between the interest rate and inflation rate in Britain during the study period due to the stability of the interest rate during most of the years of study at 0.5%. The correlation between the variable unemployment rate and the inflation rate in Britain during the study period (2003-2016) was found to be insignificant at 0.05 levels, indicating that there is no correlation between the variable unemployment rate and the inflation rate in Britain during the study period. The mean value of unemployment rate stayed stable during the sampled time period with a minimum variation of 0.02%. When examining the relationship between the variable growth rate in real GDP and the inflation rate in Britain during the study period (2003-2016), the relationship was not significant at 0.05, indicating that there is no correlation between the growth variable in real GDP and the inflation rate in Britain during the study period.

When examining the relationship between the variable net lending ratio of GDP and the inflation rate in Britain during the study period (2003-2016), the p-value for the relationship was found highly significant, indicating that there is a strong correlation between the variable net lending ratio of GDP and inflation In Britain during the study period. The correlation between the GDP gap ratio and the inflation rate in Britain during the study period (2003-2016) was found to be insignificant at 0.05 level, indicating that there is no correlation

between the variable GDP gap ratio and inflation rate In Britain during the study period. The correlation between the ratio of total debt to GDP and the inflation rate in Britain during the study period (2003-2016) was found to be insignificant at 0.05, indicating that there is no correlation between the ratio of total debt to GDP and inflation in Britain During the study period. When examining the relationship between the current account balance ratio of GDP and the inflation rate in Britain during the study period (2003-2016), the relationship was found significant at 0.05 levels. This indicating that there is no correlation between the variable current account balance of GDP and inflation In Britain during the study period. When examining the relationship between the variable investment ratio of the GDP and the inflation rate in Britain during the study period (2003-2016), the sig value of the relationship was not supporting the relationship, indicating that there is no correlation between the variable investment ratio of GDP and the inflation rate in Britain During the study period. When examining the relationship between the variable saving ratio of GDP and the inflation rate in Britain during the study period (2003-2016), it is found that the relationship is insignificant. No correlation between the variable saving ratio of GDP and the inflation rate has been found in Britain during the study period.

5. CONCLUSION

This study concluded that targeting inflation is a monetary policy framework through which the central bank can reduce inflation

rates in the short term and maintain long-term price stability. To implement the inflation targeting policy successfully, a large degree of independence of the central bank must be available to the pressures or effects of fiscal policy, the availability of conditions that allow flexibility in interest rates and the exchange rate regime, the existence of sophisticated financial markets and the low effects and factors leading to financial instability Availability of a strong and sound banking system. Monetary policy has a significant impact on the policy of targeting inflation in the case of the application of optimal and proper monetary policy tools. The UK experience is one of the successful experiences that has revealed many positive aspects of the inflation targeting policy and is an encouraging experience for emerging markets. This is due to the success of this country in keeping inflation within the target range, reducing the need for deflationary policies. However, there are some negative effects of inflation targeting policy on economic activity. It is imperative to provide all means and tools that help to implement the correct and proper inflation targeting policy to obtain the desired results. Further, it is important to study all the positive and negative effects of inflation targeting policy to prevent any negative effects appear in the inflation targeting policy implementation. Reliance on techniques and statistical models in the prediction of inflation rates, which helps to achieve the required economic development. The use of monetary policy tools in a proper manner to maximize the benefit of inflation targeting policy is evident.

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