



## Inflation Targeting Regime

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Since the adoption of a free-floating exchange rate regime as a consequence of the balance of payments crisis of 1994-1995, the exchange rate ceased to be the policy instrument that consolidated inflation expectations around the authority's objectives. Monetary policy became what in technical terms is known as the economy's nominal anchor.

The monetary policy regime was modified with the aim of increasing its effectiveness and transparency in the face of the changes undergone by Mexico's economy. As a result, policy has evolved toward an inflation targeting regime. This monetary policy regime was used for the first time in 1990 by New Zealand. Since that time, various countries, developed and emerging, have adopted this regime as a result of problems with strategies based on monetary aggregates or exchange rate targets. Among the developed countries that have adopted this approach are, in addition to New Zealand: Australia, Canada, England, Iceland, Norway, Sweden, and Switzerland. Among emerging countries are: Brazil, Chile, Colombia, South Korea, the Philippines, Hungary, Israel, Peru, Poland, the Czech Republic, South Africa, and Thailand. The main characteristics of this monetary regime, which is focused on attaining inflation targets, are as follows:

- a) The recognition of price stability as the fundamental monetary policy goal.
- b) The announcement of medium-term inflation targets.
- c) The presence of an autonomous monetary authority.
- d) The implementation of monetary policy within a framework of transparency, which is based on a strategy for communicating the targets, plans and decisions of the monetary authority.
- e) An analysis of all the sources of inflationary pressure with the aim of evaluating the future trajectory of price increases. This analysis is the main reference point for monetary policy decisions.
- f) The use of alternative inflation measures, such as core inflation, in order to pinpoint those phenomena that affect inflation temporarily and identify the medium-term tendency of price increases.

Among the benefits obtained by countries that have adopted this regime, the following stand out:

- a) Greater transparency and better understanding of monetary policy implementation.
- b) An improved rendering of accounts by the monetary authority.



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- c) Reduced inflation and inflation volatility, as well as consolidation of price stability.
- d) A diminished impact on inflation from shocks produced by other economic variables, such as the exchange rate.
- e) Anchoring of inflation expectations around the inflation target.
- f) Lower costs associated with the disinflation process.
- g) Favorable performance from other economic variables important to public well-being, such as exchange rate volatility.

The document titled “The Monetary Policy Regime” describes the key characteristics of the inflation targeting regime currently used by Banco de México.