ELSEVIER

Economic Systems 25 (2001) 233–251

ECONOMIC SYSTEMS

www.elsevier.com/locate/ecosys

From inflation targeting to the euro-peg A model of monetary convergence for transition economies

Lucjan T. Orlowski*

Sacred Heart University, 5151 Park Avenue, Fairfield, CT 06432, USA

Abstract

This study proposes a sequence of monetary convergence to the eurozone, based on autonomous monetary policy rather than on an early application of the euro-peg. The gradual adjustment process begins with a relatively strict variant of inflation targeting, followed by flexible inflation targeting, and ends with exchange rate targeting. A model outlining the optimal mode of policy adjustment is presented. The analysis warns against a premature peg to the euro, which may instigate real currency appreciation, large capital inflows and their costly sterilization. The euro-peg can be introduced only when the candidates' monetary authorities reach a certain degree of "foundational credibility". The model of monetary convergence is followed by the empirical assessment of inflation targeting in the Czech Republic and Poland. © 2001 Elsevier Science B.V. All rights reserved.

JEL classification: E32; E52; P33

Keywords: Inflation targeting; Monetary convergence to the eurozone; Transition economies; Monetary policy credibility

1. Introduction

The main objective of this study is to design a proper sequence of adjustments in the monetary systems of the candidates for accession to the European Union (EU) and, at a later stage, to the European Monetary Union (EMU).

A key assumption for the presented analysis is that the candidates will be well advised to achieve monetary convergence by applying autonomous monetary policies based on direct inflation targeting (DIT). Such an approach will enable them to accomplish price stability and to enhance policy credibility by internal means. I argue that a premature peg to the euro

* Tel.: +1-203-371-7858; fax: +1-203-230-9860.
E-mail addresses: orlowskil@sacredheart.edu, ltorlowski@aol.com (L.T. Orlowski).

0939-3625/01/$ – see front matter © 2001 Elsevier Science B.V. All rights reserved.
PII: S0939-3625(01)00020-6

would cause more damage than benefit for the central European transition economies (TEs) that wish to enter the EU and EMU. The candidates for the EU/EMU accession need to achieve price stability prior to pegging their currencies to the euro. Otherwise, the euro-peg accompanied by inflation persistently higher than that of the eurozone would trigger real appreciation of their currencies and aggravate their balance of payments position.

The recommended sequence of monetary convergence begins with a relatively strict inflation targeting regime, which will allow central banks to focus on reducing inflation to the pre-determined trajectory of disinflation. Ultimately, this trajectory is geared to the degree of price stability that is indispensable for accession to the eurozone. At the same time, central banks are expected to focus on lowering inflation variability. After achieving initial gains in price stability, the candidates are advised to switch to a more flexible variant of inflation targeting, which will gradually permit them to increase the emphasis on exchange rate stability. At the final stage of the monetary convergence process, inflation targeting will be replaced with exchange rate targeting — the euro-peg — that will secure a smooth transition to the eurozone.

The analysis begins with the presentation of key underlying policy assumptions in Section 2. On their basis, a dynamic model of policy adjustments from direct inflation targeting–exchange rate targeting (DIT–ERT model) is advanced in Section 3. The theoretical framework is followed by an examination of the empirical record of monetary policy adjustments in the Czech Republic and in Poland, which is presented and reviewed in Section 4. The concluding Section 5 identifies selected institutional and structural conditions for the successful future monetary convergence.

2. Policy assumptions

In preparation for accession to the EU and, at a later time, to the EMU, central and eastern European TEs need to design an effective program of monetary convergence. They need to intensify a final attack on inflation, and to develop immunity against external price shocks and contagion effects of world financial crises. Before proposing a model of monetary convergence to the EU/EMU, it is essential to make several assumptions reflecting the conditions and the institutional advancement of monetary policies in TEs.

A critical assumption for this analysis is that the EU/EMU candidates will be well advised to rely on internal means of achieving price stability. In other words, they will be better off pursuing disinflation through autonomous monetary policies with relatively flexible exchange rates rather than by rushing to the euro-peg.[1] They need to overcome internal sources of inflation, such as nominal indexation of wages and prices, as well as to reduce structural deficiencies associated with insufficient competition in the private sector. If the candidates apply an euro-peg prematurely, the prolonged high inflation will instigate real currency appreciation that will ultimately lead to growing current account deficits and to an unfavorable risk structure of capital inflows (the advantage of short-term over long-term capital inflows). A strong real appreciation stemming from a premature euro-peg may

[1] A support for monetary convergence that begins with the introduction of flexible exchange rates can also be found in Masson (1999) and in Hölscher and Vinhas de Souza (2000).

دریافت فوری ← متن کامل مقاله

ISIArticles
مرجع مقالات تخصصی ایران

- ✓ امکان دانلود نسخه تمام متن مقالات انگلیسی
- ✓ امکان دانلود نسخه ترجمه شده مقالات
- ✓ پذیرش سفارش ترجمه تخصصی
- ✓ امکان جستجو در آرشیو جامعی از صدها موضوع و هزاران مقاله
- ✓ امکان دانلود رایگان ۲ صفحه اول هر مقاله
- ✓ امکان پرداخت اینترنتی با کلیه کارت های عضو شتاب
- ✓ دانلود فوری مقاله پس از پرداخت آنلاین
- ✓ پشتیبانی کامل خرید با بهره مندی از سیستم هوشمند رهگیری سفارشات