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Inflation Targeting and Inflation Persistence: New Evidence from Fractional Integration and Cointegration

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Research Highlights:

- Inflation persistence (IP) is examined from a global perspective.
- IP declined in inflation targeting (IT) countries as in the global economy.
- We examine persistence in IT countries relative to Germany and U.S.
- We examine stochastic trends in IT countries relative to Germany and U.S.
- Global economy was significant for IP decline in industrial countries.

Abstract

We investigate the dynamics of inflation persistence for a sample of advanced (Canada, Sweden, and the United Kingdom) and newly industrialized and emerging market (Chile, Israel, and Mexico) economies that adopted inflation targeting (IT) prior to the year 2000. We employ fractional integration and cointegration techniques and provide empirical evidence on two yet unanswered questions. First, we investigate whether each of these six countries shares a common persistence with two non-IT countries, Germany, the largest economy of the Euro Area, and the United States, the world's largest economy, that arguably represent the main core of the global economy. Second, we examine whether the inflation in each of the six IT countries and Germany and the United States are driven by a common stochastic trend. The evidence on these issues is mixed. We find that the inflationary processes in Germany, the United States, and the three advanced economies are fractionally integrated, stationary, mean reverting, and share a common inflation persistence. On the other hand, the inflationary processes in the three emerging market economies are fractionally integrated, mean reverting, non-stationary, and do not share a common persistence with Germany and the United States. We also find that in the post-IT period Sweden is fractionally cointegrated at the global level, i.e., with both Germany and the United States, whereas Canada is fractionally cointegrated at the regional level, i.e., only with the United States. Mixed evidence on the effects of the global financial crisis and its aftermath is also reported.

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