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DOES INFLATION TARGETING MATTER FOR FPI: EVIDENCE FROM PROPENSITY SCORE MATCHING

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ABSTRACT

The aim of this paper is twofold. Firstly, it seeks to investigate the nature of the relationship between inflation targeting regime and foreign portfolio investment inflows. Secondly, it inquires whether inflation targeting is able to control for foreign portfolio investment volatility in emerging countries or not. The sample covers the period 1986-2010 and contains 38 emerging countries, of which 13 countries have adopted inflation targeting. By addressing the self-selection bias via a variety of propensity score matching techniques, results show that a full-fledged inflation targeting adoption increases foreign portfolio investment inflows into emerging countries, but they show no robust results for containing foreign portfolio investment volatility. This would indicate that inflation targeting adoption is beneficial for emerging countries since it has permitted to attract more foreign portfolio investment inflows. On another front, these results tend to indicate that inflation targeting is rather contributing to amplifying portfolio investment volatility, albeit such finding is far from being robust and depends on the model specification and the matching technique. The study's results may be useful in guiding policymakers towards widening the scope of inflation targeting regime to encompass financial stability in addition to price stability.

Keywords: Inflation targeting, Propensity score matching, Portfolio investment, Emerging market countries.

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