

Assessment of Time Inconsistency of Monetary Policy in the Approach of Exchange Rate Targeting Rule in Iran

*Mohsen Rahimzadeh Namvar**

*Mansour Khalili Araghi***

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Abstract

This research assesses the time inconsistency of monetary policy in Iran using the exchange rate targeting approach. The level of alignment of Nominal anchor (money growth) with the actual values of the economy indicates weak credibility of monetary policy. The empirical model uses seasonal data for the period of 1989-2017 based on generalized method of moments (GMM). The results show that the effect of the output gap on the reduction of the exchange rate deviation in the floating exchange rate is more than the fixed system. It is observed that, contrary to the output, the effect of the inflation rate gap on the exchange rate deviation in the floating exchange rate system is less than the fixed exchange rate system. This suggests that in terms of exchange rate targeting and commitment to a ruled monetary policy, the impact of the inflation gap is higher on the exchange rate gap in the fixed exchange rate system compare to floating one.

Keywords: exchange rate, inflation rate, time inconsistency, commitment policy, discretion.

JEL classification: F31, P24, E58, C61, C13.

* PhD student in Economics, University of Tehran.
Email: mrmamvr@gmail.com

** Professor of Economics, University of Tehran.
Email: khalili@ut.ac.ir



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