

Discuss the Pros and Cons of Changing the Inflation Target Should Central Banks be Responsible for Macroprudential Oversight?

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Keywords: inflation target, central banks, responsible, macro-prudential, advance or disadvantage

Abstract: Following the financial crisis of 1997, the United States happened the financial crisis and then the rest countries also started to affect the economy of the world. In addition, in the last financial crisis of 2008–2009, some researchers found the importance of the inflation target. Indeed, the inflation target may support a nominal anchor for monetary policy in the financial framework. The main contributions of the present paper can be summarized as follows: This paper is divided into two sectors. The first sector has described the advantages and disadvantages of the changing inflation target. The second sector has discussed the relationship between the central bank and the macro-prudential.

1. Introduction

Following the financial crisis of 1997, the United States happened the financial crisis and then the rest countries also started to affect the economy of the world. In addition, in the last financial crisis of 2008–2009, some researchers found the importance of the inflation target. Indeed, the inflation target may support a nominal anchor for monetary policy in the financial framework. As Hassan et al. (2018) point out, due to the concern that the high inflation target will threaten the forecast ability, many countries encourage changing the inflation target in practice. In December 2008 Federal Reserve's monetary authority was forced to transfer the target of the fund rate to the zero. This activity may help the country to stimulate the economy and solve the credit crisis (Ireland, 2007). Indeed, Inflation targeting is a monetary policy, the traditional point about the inflation target is that the central bank may encourage economic development by increasing or decreasing the interest rates. Bernanke and Gertler (2001) illustrate that the central bank plays a significant role to maintain the stability of the economy. In essence, the policy resolution includes the two stages. As Ueda and Valencia (2014) point out, in the first step, before the credit shock, monetary and macroprudential oversight are deciphered at the same time.

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2. The inflation targeting

As stated above, this essay briefly explains why the Central Bank adopted the inflation target model. Even though the process of changing the inflation target has certain drawbacks, some nation still admits the benefits, because they believe that changing the inflation target is likely to help the country enhance its economic development. In this section, some benefits and problems associated with changing the inflation target will be separated to discuss.

2.1 The advance of the changing inflation target

Inflation targets may also help the market maintain price stability which is one of the major benefits that can be achieved through monetary policy in the long run. However, this may lead to a slow increase in the GDP rate. Indeed, changing the inflation target would benefit the economy.

For the flexible inflation targeting, the most direct impact on the economy is able to increase in employment rate and increase in the output. When the nation's economy suffers frequently slow growth, then the Central Bank has to issue the money to stimulate the economy. Additionally, this will lead to a drop-in interest rate and encourage people to buy more bulk products. As mentioned above, firm holders should be able to add more labor supply. This may lead to an increase in product output and lower unemployment levels in the floating inflation market. In order to suggest this opinion, Stein (2018) explains that due to the greater share of the interest rate cuts, the Central Bank might increase the inflation targets. As emphasized by Ireland (2007), the inflation target is likely to change exogenously under the Taylor rule, and this permit that the inflation target may be shifted by the central bank for the purpose of the two supply shocks. As noted above, the goods' price will be increased by adverse supply shocks, while the advantageous supply shocks will decline the prices. In light of the pieces of knowledge, the Federal Reserve translates the short-run price so as to produce more motivation after the post-war period.

Essentially, it is very difficult to maintain a constant inflation target, as most countries make inflation target through a tolerance band. However, it does not mean that the Central Bank has an idea that the inflation target could get bigger and bigger. Indeed, low and stable inflation is the goal that can help the nation to maintain the good's price. In addition to investigation on the inflation target with a tolerance band, Andersson and Jonung (2017) claim that it would bring about more benefits than the traditional economy. They brought discovered an idea that the Central Bank approach to dealing with developments that may hinder future financial stability with flexibility ability when a nation chooses the explicit tolerance band in the inflation target.

2.2 The disadvantage of the changing inflation target

Although the inflation target can positively impact the economy market, there are still some underlying problems, which would be introduced the problems of changing the inflation target in the next section.

The Inflation targeting illustrates the price level under the market economy, however, the Central Bank finds it difficult to limit the inflationary trend and also lacks a clear policy goal. Therefore, this implies that the Central Bank is not able to forecast the further trend of the economy, because the inflation target will experience uncertainties. For example, since 1980, the purpose of the Federal Reserve involves restoring the low inflation target, therefore, they chose the model of opportunist by supply-side disturbances. Ireland (2007) discovered that the Federal Reserve inflation target has a significant uncertainty about the real source of motivation in the long- term. He explained that describing the motivation is a random variance in the inflation target

Additionally, these results are coherent with Svensson (2002) who provides the evidence to indicate that model uncertainty will cause motivation bias in the long-run inflation target. This evidence directly explains that the model is an intricate process to forecasting the inflation targeting, therefore, it will hinder the prediction of the further inflation target. On the other hand, the inflation target will be uncertainty when the Central Bank provides an incomplete parameter, and then he illustrates that it is a different problem.

3. Macro-prudential oversight

Macro-prudential oversight activities are likely to find the risks in the supervision departments of the financial authorities and may find the reason affecting the development of macroeconomics. In addition, the Central Bank has the function of creating credit that facilitates money liquidity. In this section, the paper will discover the relationship between Macro-prudential oversight and the Central Bank.

3.1 The Central bank should be responsible

Indeed, in order to prevent the financial crisis, the nation is likely to regulate the crisis through more rigorous Macro-prudential oversight. There are two reasons for the argument that the Central Bank should be responsible for macro-prudential monitoring: the Central Bank can obtain

information about financial supervision and the Central Bank's independence and liquidity management.

Firstly, the Central Bank may obtain some correct information by using particular methods, while the information could further influence the economic system. In practice, in order to understand the lender's repayment ability, the financial supervision information will play a key role. This is because the bank can make a reasonable judgment based on that information. This means that the quantity of unpaid credit may decrease for any size of the banking systems. Furthermore, it is likely to help the bank to avoid ethical dilemmas. Indeed, Crockett (2000) provided evidence that the major reason for financial instability is due to incomplete information from the safety net cannot solve the moral hazard issues.

The Central Bank is a positive participant in the financial market. Therefore, it has a close tie to different financial functions. Indeed, this relevance may build up a significant source of information. Moreover, this relationship may help the Central Bank to obtain timely and useful information about the financial market's development trend, such as market liquidity. In essence, this information may be attained by the Central Bank through complementation with the regulatory approval information. As emphasized by Vogel et al. (2015), the Central Bank can maintain track of the supervision process related to the documents, according to the new macro-prudential database, such as the annual reports, inflation reports and financial stability reports of the national central bank.

3.2 The Central Bank should not responsible

On the other hand, some people have argued the point that the Central Bank should not responsible for macro-prudential monitoring, the reason that there is a potential conflict between financial regulation and monetary policy, that the Central Bank has less regulation experience, especially to the financial products company and financial authorities.

Firstly, the potential conflict is the Central Bank may be more anxious about the financial regulatory system when the Central Bank may unduly implement easing or tightening of the monetary policy. Loannidou (2005) illustrates that the Central Bank may implement relatively less supervision if the Fed tightens the monetary policy in the financial market. Moreover, this may lead to the price fluctuation of goods. Indeed, this is a useful way to keep the price that may promote the development of the economy. In other words, in order to boost the Central Bank's task of controlling the inflation rate, the Central Bank should not be responsible for the regulation. Note that Angelini et al. (2011) arrived at a similar conclusion: the conflict proceeds from the two independent authorities, which they have different targets. In practice, two ministries may create a conflict when they do not cooperation well together. In addition, these results concur with those of Claeys and Schoors (2007) who claimed that the implementation of supervisory standards is likely to lead to many conflicts due to excessive regulatory tolerance.

4. Conclusion

The guiding principle of inflation is likely to keep the good's price and then facilitate economic development. Indeed, in order to maintain the stability of inflation and output, this option will indirectly affect the all-economy market. On the other hand, the Central Bank is managed by the nation and then is likely to make the monetary policy.

This paper discusses the benefits and problems of changing the inflation target and then discusses the relationship between the Central Bank and macro-prudential oversight. Additionally, to prove the benefits or problems, mass references can be provided in this paper by the author. The advantage of changing the inflation target is that it can boost economic development in many variable ways. However, the inflation target can bring a positive effect to the economy market, problems always accompany the benefits. Even the inflation target can bring a positive influence on the economy market, problems always accompany the benefits. So, the problems of changing the inflation target are difficult to manage and forecast. In addition, the paper discusses whether the Central Bank should be responsible for the macro-prudential. In essence, the Central Bank has some advantages to obtain regulation information. And it can supply independence function and liquidity management

ability. According to this, the Central Bank should be responsible for macro-prudential oversight. In contrast, there is a potential conflict between the Central Bank and the regulation system. And the Central Bank does not have enough experience to regulate the other area financial company. According to this, the Central Bank should not responsible for the macroprudential oversight. At present, the world of the bank has not yet the same knowledge about this question.

However, in order to solve the problem of ineffective supervision, the reform of the financial regulatory system must necessary. So, building the financial regulatory framework of the relationship between the Central Bank and the Macro-prudential is according to the different situations of the country.

Word count: 1875

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