
STRUCTURAL DIFFERENCES IN INFLATION DYNAMICS BETWEEN DEVELOPING AND ADVANCED COUNTRIES

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Résumé

Abstract

Mainstream theories/models treat macroeconomic dynamics in advanced and developing countries in the same way. In this sense, mainstream theories/models on inflation dynamics are not exceptions. As opposed to mainstream economics, this study focuses on the differences in inflation dynamics between developing and advanced countries and possible policy implications. First, the main findings of this study suggest that supply side factors such as exchange rates and commodity prices appear to play a far greater role in determining inflation in developing countries. This may greatly undermine the crux of the inflation targeting (IT) framework for developing countries. If the major sources of inflation are related with supply side factors which are generally beyond what monetary policy can easily influence, affecting inflation through the impact of policy interest rates on aggregate demand and expectations may not lead to desired outcomes. In this sense, it is quite likely that inflation targets would be missed depending upon external conditions such as international commodity prices or exchange rates, eroding the credibility of the IT central banks in developing countries. As a result, in order to gain credibility and take inflation under control, IT central banks may resort to asymmetric exchange rate policy more often than advanced countries and favor appreciation (try to avoid depreciation) of their currencies. In this sense, IT seems to contribute to the ignorance of dangers regarding to over-appreciation of currencies in developing countries. Second, although many studies do not report significant inflation differentials across income groups for advanced countries, poor households may be exposed to higher inflation than rich households on average in developing countries due to mainly supply side/structural forces. Structural problems increase relative price variability across goods and services in these countries. In addition, income inequality across households is relatively higher in the developing countries. Thus, one may expect higher inflation differentials across household groups in developing countries than developed countries. This striking finding may require strong policy actions such as calculating and announcing more than one inflation rate, setting minimum wages according to relevant inflation rate, monitoring food prices, and addressing non-competitive nature of markets which are important for poor people.

Mots-Clés: Inflation dynamics, Developing countries

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