

Inflation targeting

Inflation targeting is a monetary policy where a central bank follows an explicit target for the inflation rate for the medium-term and announces this inflation target to the public. The assumption is that the best that monetary policy can do to support long-term growth of the economy is to maintain price stability, and price stability is achieved by controlling inflation. The central bank uses interest rates, its main short-term monetary instrument.

An inflation-targeting central bank will raise or lower interest rates based on above-target or below-target inflation, respectively. The conventional wisdom is that raising interest rates usually cools the economy to rein in inflation; lowering interest rates usually accelerates the economy, thereby boosting inflation. The first three countries to implement fully-fledged inflation targeting were New Zealand, Canada and the United Kingdom in the early 1990s, although Germany

had adopted many elements of inflation targeting .

Price Level Targeting

Price level targeting is a monetary policy framework that can be used to achieve price stability. Like inflation targeting, price level targeting establishes targets for a price index like the consumer price index (CPI). But, while inflation targeting is forward looking, price-level targeting looks at past price changes and commits to reversing any temporary deviations from the target rate of inflation.

For instance, if inflation fell below 2% for some time looking backward, the central bank would compensate by aiming for inflation above 2% temporarily until average inflation over the whole period had returned to 2%.

Monetary

Aggregates

Money aggregates are broad categories that measure the money supply in an economy. In the United States, labels are attributed to standardized monetary aggregates:

M_0 : Physical paper and coin currency in circulation, also known as the monetary base

M_1 : All of M_0 , plus traveler's checks and demand deposits

M_2 : All of M_1 , money market shares, and savings deposits

A legacy aggregate known as M_3 , which further included time deposits over \$100,000 and institutional funds, has not been tracked by the Federal Reserve since 2006 but is still calculated by some analysts