Adoption of Inflation Targeting Framework in Vietnam

Nguyen Thi My Hanh(1)

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ABSTRACT: This study investigates the adoption of inflation targeting framework in Vietnam. This work is done by examining the satisfaction of one crucial prerequisite of inflation targeting that there is the existence of predictable and stable linkages between monetary policy instruments and inflation outcomes. The Johansen multivariate cointegration procedure and vector error correction model approach are designed to realize the relationship between monetary policy instruments and inflation, and the findings point out that there exists a stable and predictable linkage between monetary policy instruments and inflation in Viet Nam. However, it is too weak. As a result, Viet Nam is not yet a candidate for adopting inflation targeting framework.

KEYWORDS: monetary policy, inflation targeting framework, Johansen test, Vietnam.

1. Introduction

The State Bank of Vietnam focuses on multi-targets of monetary policy while other central banks in the world only focus on price stability. From 2012 until now, inflation of Vietnam is always controlled at one single digit. However, there is no pledge of The State Bank of Vietnam to stabilize prices in the long term, and as a result, inflation expectations which are essential for price stability could not be anchored. It means that inflation might occur any time, which threatens the economy very severely like what happened in the period 2008–2012.

At the moment, Vietnam is choosing to manage exchange rate, or in other words, the exchange rate is seen as a nominal anchor for Vietnam's monetary policy. According to the impossible trinity theory, it is impossible to have all three of the following at the same

Nguyen Thi My Hanh
Email: hanhntm@buh.edu.vn.

(1) Banking University HCMC - 36 Ton That Dam Street, Nguyen Thai Binh Ward, District 1, HCMC.