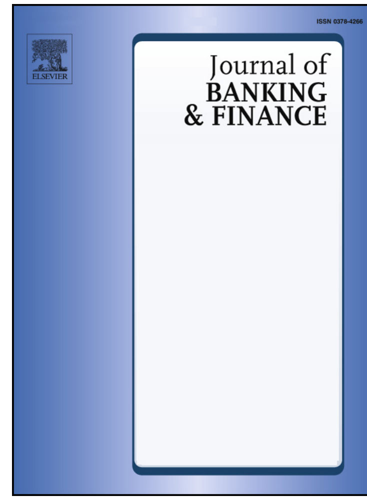
Accepted Manuscript

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PII: S0378-4266(15)00162-4
DOI: http://dx.doi.org/10.1016/j.jbankfin.2015.05.016
Reference: JBF 4743

To appear in: *Journal of Banking & Finance*

Received Date: 9 October 2014
Accepted Date: 12 May 2015

Please cite this article as: Fazio, D.M., Tabak, B.M., Cajueiro, D.O., Inflation Targeting: Is IT to blame for Banking System Instability?, *Journal of Banking & Finance* (2015), doi: http://dx.doi.org/10.1016/j.jbankfin.2015.05.016

# Inflation Targeting: Is IT to blame for Banking System Instability? ☆

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This version: June 15, 2015

**Abstract**

In light of the financial crisis, the practice of inflation targeting (IT) has been blamed for authorities' failure to respond to the increase in financial systemic risk and to the development of asset bubbles. However, utilizing a rich database containing nearly 5500 commercial banks from 70 countries (among which, 22 are IT) for the period 1998-2012, this paper argues that on average, inflation targeting national banking systems (i) are more stable; (ii) possess sounder systemically important banks; and (iii) are less distressed than (or at least as distressed as) other banks during periods of global liquidity shortages. Our results are robust to a series of tests, such as when we compare countries with the same legal origins or control for the delegation of bank supervision responsibility to bodies other than the central bank. Overall, we conclude that IT cannot be blamed for contributing to financial fragility.

*Keywords:* inflation targeting, financial stability, monetary policy, financial crisis, bank regulation
*JEL classification:* D40, E52, E58, G21, G28

☆The authors would like to thank, Carol Alexander (the editor), and two anonymous referees for their for their valuable comments and suggestions to the paper. We would also like to thank, without implicating: Iftekhar Hasan, Bill Francis, Tuomas Peltonen, Eduardo Lima, Aquiles Faria, Marcio Garcia, Katherine Hennings, Marta Baltar, Solange Guerra, Naércio Menezes, Luiz Alberto Esteves, Marcelo Zeuli, Carlos Hamilton Araújo, Francisco Figueiredo, Rafael Terra, and the participants at the XVI Annual Inflation Targeting Seminar of the Banco Central do Brasil. The authors are grateful to financial support from CNPQ foundation. All remaining errors are our own.

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