Analyzing the Effects of Inflation Targeting on Foreign Direct Investment Inflow: Evidence from Propensity Score Matching Approaches

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Abstract:

This study assesses the effectiveness of inflation targeting (IT) on foreign direct investment (FDI) inflows to emerging-developing and upper-middle-income economies. Foreign direct investments are a resource that improves employment opportunities and contributes to economic growth and a long-term financing resource for developing economies. Especially emerging-developing economies achieve a stronger economic outlook after switching to inflation targeting regimes. The research utilizes the propensity score matching method for the period 1990–2019 to assess whether economies that adopt inflation targeting increase their FDI inflows. Several matching methods are used to analyze the impact of inflation targeting contributing FDI flows over the study period. The results from all matching techniques show the increasing importance of inflation targeting on FDI over time, especially for emerging economies. In both country groups, the inflation targeting regime attracting foreign direct investment relies on pull factors in a recipient economy, highly attributed to domestic macroeconomic conditions. Revealing these results about the influence of inflation targeting gives better insight for policymakers, especially for developing-emerging and upper-middle-income economies, in terms of designing correct policy decisions increasing attractiveness foreign investors. The research also reveals that implementing inflation targeting compared to alternative monetary policies increases the foreign direct investment inflow for the economies that use this monetary policy.

Keywords: Inflation targeting, Foreign direct investment, Propensity Score Matching

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