

Monetary Targeting Controlling Money to Control Inflation

Hi, I'm Douglas Laxton — but you can call me Doug.

In this video, we're going to talk about something that played a major role in the evolution of modern central banking — **monetary targeting**.

After the Great Inflation of the 1970s, central banks around the world were searching for a better way to control inflation. One of the most influential voices at the time was **Milton Friedman**, who famously said:

“Inflation is always and everywhere a monetary phenomenon.”

That idea gave rise to what we now call *monetary targeting* — the belief that if you could control the growth of money in the economy, you could bring inflation under control.

One country that took this approach especially seriously was **Germany**. The Bundesbank introduced formal targets for the growth of money — such as M1 or M2. Even after Germany joined the euro, this tradition influenced the **European Central Bank**, which maintained a *monetary pillar* in its policy framework, reflecting the idea that money growth still held useful signals about inflation risks.

Now contrast that with **Canada**.

Canada also tried monetary targeting in the 1970s but abandoned it by the early 1980s. Why? Because the relationship between money and inflation had broken down. Financial innovation, new technologies, and changes in how people used money made it impossible to control money growth reliably.

Gerald Bouey, Governor of the Bank of Canada at the time, summed it up perfectly:

“We did not abandon monetary aggregates. They abandoned us.”

That quote captures an important truth: even when a theory seems right, it doesn't always work in practice.

Here in **Armenia**, we also used monetary targeting in the late 1990s and early 2000s. It was helpful then — stabilizing expectations after a difficult transition period. But, like elsewhere, we found that monetary aggregates were becoming less useful as guides for policy. So, in the mid-2000s, we began transitioning to a more modern, forward-looking framework — first **FPAS Mark I**, and then **FPAS Mark II**, which we use today.

The key lesson:

Monetary targeting helped bring discipline when it was needed most. But in modern economies — where financial systems evolve rapidly — it's not enough.

That's why today we focus on the **price of money** (interest rates) and on **expectations** — how people think about future inflation.

This is the foundation of credible monetary policy in today's world.

Thanks for listening. I'm Doug — and in the next video, we'll explore how **inflation targeting** became the dominant framework in central banking.