

Abstract

This paper tries to assess the Ethiopian monetary policy, in order to investigate the prospect of inflation targeting. The paper starts by reviewing the literature on the evolution of Ethiopian monetary policy and Macroeconomy. This is followed, by the requirements of adopting inflation targeting and the practical experience of inflation targeting countries; finally the paper focuses on the requirement to have a stable and persistent relationship between the policy instrument and price level. Vector auto regression model with some monetary policy instrument and macroeconomic variables was used. To explore different transmission mechanism i have analyzed the Granger causality, impulse response, and Variance decomposition. Result showed that, there is a weak relationship among prices, interest rate and exchange rate channel. The paper, therefore, recommended it is not the right time to adopt the full-fledged inflation targeting. Rather, better try to adopt inflation targeting as an implicit policy.