

Policy implications of losing credibility: Lessons from Colombia’s post-pandemic inflationary surge*

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Abstract

Inflationary surges, such as those observed in the aftermath of the COVID-19 pandemic, can reduce the credibility of central banks’ inflation targets. We use data from expectations surveys to test if there were credibility losses in Colombia and assess their magnitude. Then we use those estimates to inform a Bayesian estimation of a monetary policy model in which such credibility is endogenous by depending on the central bank’s past performance on reaching its inflation target. We implement our framework embedded in one of the main semi-structural models for monetary policy analysis in the country, the 4GM-model (Gonzalez et al., 2020). Our implementation is such that the 4GM specification is nested in our model as a particular case where the costs of credibility losses are absent. We find that, the post-pandemic inflationary surge in Colombia represents the episode with the largest credibility loss in recent decades, and episodes with such credibility losses make inflation stabilization policies more costly in terms of output.

Keywords: Credibility, expectations, inflation, monetary policy, non-linear.

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