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Determining the exchange rate pass-through on inflation is a necessity for central banks as well as for firms and households. This is an apparently easy and intuitive task, but it faces high complexity and uncertainty. This paper examines the nature of the pass-through and quantifies historically their short and long-term impact on prices along the distribution chain. The paper uses monthly data from a small open economy and a smooth transition autoregressive vector model estimated by Bayesian methods. The main findings are that pass-through is incomplete, endogenous and then changes over time, nonlinear and asymmetric in the short and long terms to exchange rate shocks and to the state of the economy (i.e., pass-through is nonlinear state-dependent). The three main policy implications of our findings are: Firstly, models used in central banks for policy making need to be adjusted to the incomplete, endogenous, nonlinear and asymmetric nature of pass-through. Secondly, there should not be a specific rule on pass-through on inflation for policy making, even in the short term. Thirdly, uncertainty about pass-through estimates increases rapidly after two years of the shock.".

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