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Commodity Price Fluctuations, Core Inflation and Policy Interest Rates

Working Paper No. 967 Keep in mind
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The world economy has recently been hit by commodity price fluctuations, with first round effects on noncore inflation and second round effects on core inflation. The policy response to commodity price fluctuations depends on the first and second round effects as well as on the strength of the central bank reaction to noncore inflation. The impulse responses and the historical error decomposition exercises show that the second round effects have followed two cycles, the first one before and after Lehman crisis; the second one, that started in 2010, exerted particularly strong downward pressure on interest rates during 2015-2016. The results are obtained with a global model of the largest five systemic economies plus one non systemic economy. In the model, latent variables are obtained with the multivariate Kalman filter and parameters are estimated with Bayesian methods.

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Update 15/06/2017, 11:42 a. m.

Fuente: https://www.banrep.gov.co/en/borrador-967