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Abstract

This paper aims to provide evidence on the relationship between fiscal and monetarypolicy in Colombia through an empirical exploration of the credit risk channel. Underthis approach, fiscal policy plays an important explanatory role in the sovereign riskpremium, which, in turn, could affect the exchange rate and inflation expectations.The Central Bank reacts to inflation expectations using the policy interest rate; conse-quently, such reaction could be indirectly influenced by fiscal behavior. Using monthlydata from January 2003 to December 2019, we estimate both jointly and independentlythe reduced-form core equations of a system that describes the credit risk channel in asmall open economy. Our findings are in line with the model predictions. Fiscal policyaffected the country's sovereign risk during this period, but only slightly. Hence, thereis insufficient evidence to sustain the idea that monetary policy has been significantlyinfluenced by government fiscal management.