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AUTHORS AND/OR EDITORS

Grajales-Olarte, Anderson Hamann-Salcedo, Franz Naranjo-Saldarriaga, Sara Pulido-Pescador, José David

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Abstract

Inflationary surges, such as those experienced in the aftermath of the COVID-19 pandemic, can undermine the credibility of central bank inflation targets. Using data from expectations surveys, we test whether credibility losses occurred in Colombia and assess their magnitude. We then use these estimates to inform a Bayesian estimation of a monetary policy model in which such credibility is endogenous, depending on the central bank's past performance in achieving 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 designed such that the 4GM specification is nested within our model as a particular case in which the costs of credibility losses are absent. Our findings indicate that the post-pandemic inflationary surge in Colombia represents the episode with the largest credibility loss in recent decades, and such episodes tend to make inflation stabilization policies more costly in terms of output.

The necessary effort to stabilize inflation is greater when credibility is low, requiring the implementation of stricter policies than usual to achieve the same inflation targets.