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Autor o Editor

Andrés González , Franz Hamann

Lack of Credibility, Inflation Persistence and Disinflation in Colombia Lack of Credibility, Inflation Persistence and Disinflation in Colombia* Andrés González

agonzago@banrep.gov.co Franz Hamann**

fhamansa@banrep.gov.co Abstract This paper measures inflation persistence in Colombia for the period 1990-2010 and estimates the implied speed at which agents learn about the central banks inflation target. We estimate Erceg and Levins (2003) imperfect credibility model using Bayesian techniques and compare the posterior odds of this model against a conventional Neokeynesian model with ad-hoc price indexation. The odds are strongly in favor of the imperfect credibility model, suggesting that lack of credibility on the inflation target is an important source of inflation persistence. We use the model to compute the sacrifice ratio associated to 100 basis points inflation target shocks and find that it is (0.83%) in line with previous estimates for Colombia. We also find that the speed at which agents learn in the model has increased, albeit marginally, since the central bank implemented its inflation targeting strategy. Although during this period macroeconomic volatility has fallen, inflation persistence has remained roughly constant suggesting that so far, the impact of those credibility gains has been modest. Keywords: Credibility, inflation, persistence, disinflation costs, Colombia. JEL

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