Policy implications of losing credibility: Lessons from Colombia´s post-pandemic inflation

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Resumen:

Inflationary surges, such as those experienced in the aftermath of the COVID-19 pandemic, can undermine the credibility of central bank inflation targets. Using survey data, we test for credibility losses in Colombia and assess their magnitude. We then use these estimates to inform a Bayesian estimation of a monetary policy model in which credibility is endogenous and depends on the central bank's past performance in achieving its inflation target. We implement our framework within one of the main semi-structural models for monetary policy analysis in the country, the 4GM-model (Gonzalez et al., 2020). Our findings indicate that the post-pandemic inflationary surge in Colombia constitutes the episode with the largest credibility loss in recent decades, and that such episodes tend to make inflation stabilization policies more costly in terms of output.

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