

# Working Papers on Economics - Policy implications of losing credibility: Lessons from Colombia's post-pandemic inflationary surge

Download Keep in mind

The series Working Papers on Economics is published by the Office for Economic Studies at the *Banco de la República* (Central Bank of *Colombia*). It contributes to the dissemination and promotion of the work by researchers from the institution. This series is indexed at Research Papers in Economics (RePEc).

On multiple occasions, these works have been the result of collaborative work with individuals from other national or international institutions. The works published are provisional, and their authors are fully responsible for the opinions expressed in them, as well as for possible mistakes. The opinions expressed herein are those of the authors and do not necessarily reflect the views of Banco de la República or its Board of Directors.

**AUTHORS AND/OR EDITORS** Grajales-Olarte, Anderson Hamann-Salcedo, Franz Naranjo-Saldarriaga, Sara Pulido-Pescador, José David

The series Working Papers on Economics contributes to the dissemination and promotion of the work by researchers from the institution. On multiple occasions, these works have been the result of collaborative work with individuals from other national or international institutions. This series is indexed at Research Papers in Economics (RePEc). The opinions contained in this document are the sole responsibility of the author and do not commit Banco de la República or its Board of Directors.

Publication Date: Wednesday, 26 of February 2025 **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.**