

Discussion of

‘Accounting for Credibility: Monetary-Fiscal Interactions and the Credibility of Central Bank Mandates’

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Recent lively debate on central bank independence

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...but relevant to date, also for advanced economies



Chip Somodevilla / Getty Images North America

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Theoretical framework:

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The cases of *Colombia* and *Chile* from 1980 to 2017

- + Fiscal fundamentals not enough to jointly explain inflation and debt-to-GDP dynamics since mid 90s
- + Need gain in credibility to explain why debt-to-GDP increases or flattens while inflation decreases

Some thoughts on the cost of losing credibility

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Could you explore any of these possibilities within your framework?

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Similar exercise in spirit to Bianchi and Ilut (2017)

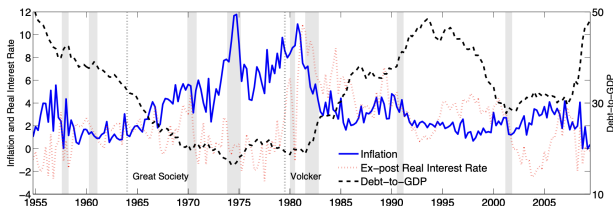


Figure 1: Annualized quarterly inflation, real interest rate, and debt-to-GDP ratio over the sample 1954:Q3-2009:Q4. The grey shaded areas represent the NBER recessions, while the two red vertical lines mark President Johnson's first ever public reference to the Great Society (May 1964) and the appointment of Paul Volcker (August 1979). Inflation is measured taking the log-difference of the GDP deflator, the ex-post real interest rate is computed taking the difference between the FFR and realized inflation in the following period, while the debt-to-GDP ratio is obtained taking the ratio between the stock of debt held by the public and annualized GDP.

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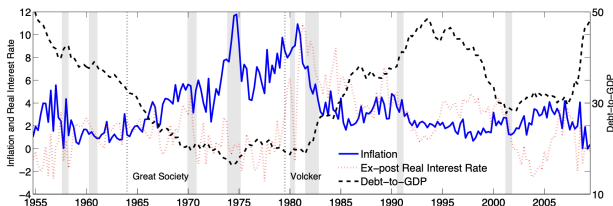


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If you ran your particle filter on US:

- Lost credibility until '79 when Volcker came into place
- Still low credibility from '79 to '81, low debt-to-GDP, high inflation
- Gain in credibility only in '81, decreasing inflation & increasing debt-to-GDP

What about inflationary episodes?

Now model used to explain deflationary episodes

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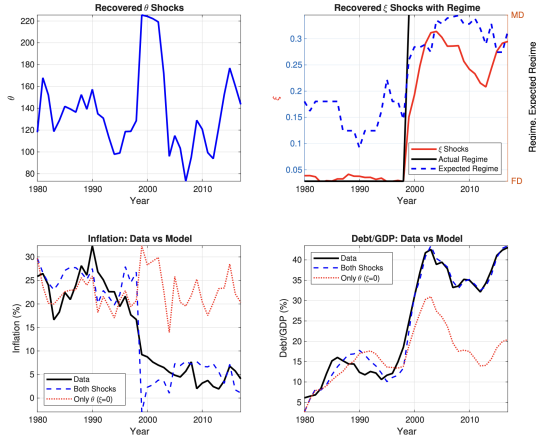
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Inflations in Colombia

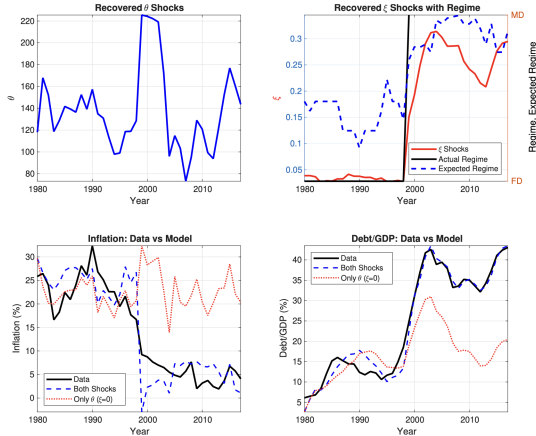
Figure 8: Colombia



Inflation and debt-to-GDP negatively correlated from 1985 to 1990

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Inflation and debt-to-GDP negatively correlated from 1985 to 1990
Should the model predict institutional inflation?

An application to the euro

Now main focus on Latin America

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Could we use the model to think about the adoption of the euro?

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Lower inflation, possibility to issue more common debt

To Recap

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Very flexible framework that allows to study many different cases!