

Did Argentina's Inflation Targeting Work? A Latin American Comparison and an Empirical Assessment

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*A Buenos Aires,
musa che ha ispirato la scrittura di questa tesi
e città che mi ha vista rinascere.*

*Alla mia famiglia,
mia fonte di vita e amore,
per avermi insegnato a puntare in alto
e a non mollare mai.*

Grazie per essere il mio più grande dono.

*A nonno Armando,
a cui dedico ogni mio traguardo.
Il tuo amore mi raggiunge oltre il tempo e la distanza.
Oggi mi manchi un po' di più.*

Abstract

This thesis investigates why the inflation targeting framework adopted by Argentina in 2016 did not deliver the disinflation it had promised, whereas Brazil, Chile, Colombia, Mexico and Peru succeeded under more favourable institutional conditions. Drawing on the literature on monetary policy in Latin America, the first two chapters identify the institutional and macroeconomic preconditions that Argentina lacked at the time of the reform: fiscal discipline, central bank independence, credible inflation statistics and a low-inflation starting point.

The third chapter estimates a Taylor Rule and an Augmented Phillips Curve for the 2000Q1–2026Q1 period, using a parsimonious hybrid New Keynesian specification with OLS and interaction terms with the inflation targeting dummy. The estimated reaction function of the central bank shows a response to inflation too large to represent a genuine Taylor-type rule, and a negative response to the output gap that partially normalises only after 2016. The Phillips Curve reveals that inflation inertia is the dominant driver of Argentine price dynamics and that it did not decline after the reform but nearly doubled, while the output gap plays no significant role in either subperiod. These findings, robust to alternative econometric specifications reported in the Appendix, indicate that the failure of the regime stemmed from the absence of the structural preconditions required for inflation targeting to function as an effective nominal anchor.

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Introduction

Background and Motivation

Unlike other Latin American economies, which succeeded in stabilizing their inflation rate in the 1990s and reinforced this success by implementing inflation targeting regimes, Argentina has been facing problems of price instability, currency crises, and credibility issues since then. The introduction of inflation targeting regime by the Macri administration was seen as a breakthrough and marked the beginning of a new era of policymaking. However, three years later, the regime failed to deliver on its promise and the country was back to square one.

The relevance of the Argentine episode extends beyond the country's own macroeconomic trajectory. If a framework that has anchored expectations elsewhere in the region failed under Argentine conditions, the more useful question is not whether inflation targeting is theoretically sound, but under which institutional and structural conditions it actually operates. Argentina therefore functions as a natural counterfactual for the theory of monetary policy in emerging markets: it makes visible which elements of the standard framework are robust to weak preconditions, and which are not.

The research question is approached in two complementary ways. First, a comparative analysis of monetary policy across Latin America identifies the structural conditions under which inflation targeting has been effective in the region. Then, an empirical investigation of Argentine inflation dynamics tests whether those conditions were present in Argentina between 2000 and 2026, and what their absence implies for the future path of domestic prices.

Research Question

The primary research question that guides this thesis is: Did the inflation targeting regime that was introduced in Argentina in 2016 serve as an efficient monetary policy framework?

In order to provide an answer to this question, three secondary questions are explored. First, what were the institutional and macroeconomic preconditions for the successful introduction of inflation targeting in Brazil, Chile, Colombia, Mexico, and Peru, and how do they differ from those in Argentina in 2016? Second, what are the structural characteristics of the economy that make inflation targeting ineffective? Third, on the basis of the empirical analysis, did the 2016 reform produce detectable structural changes in the central bank's reaction function and in the inflation process, and along which dimensions?

Organization of the Thesis

The thesis is organised in the following manner. The first chapter gives a background of inflation targeting in Latin America, highlighting the process of disinflation in the 1990s, how the central bank institutions were strengthened in the region, empirical studies on whether monetary policies were consistent with the Taylor Rule, and the changing Phillips Curve of the five inflation targeting countries.

Then, the second chapter highlights the context in which the inflation targeting regime in Argentina was set up before the change in 2016, reasons for failure of inflation targeting, and structural differences that made Argentina structurally distinct from its neighbours. Between the reasons, it is possible to identify fiscal dominance, exchange rate pass through, and inflation inertia.

Finally, the third chapter focuses on the empirical investigation, covering the period 2000Q1–2026Q1. The chapter starts by describing the data sources and methodology, then specifies the two econometric models estimated: a Taylor Rule and an Augmented Phillips Curve, both estimated using a parsimonious hybrid New Keynesian specification with OLS. Each model incorporates an inflation targeting dummy variable, interacted with the main explanatory variables, in order to test whether the 2016 regime change produced a structural shift in the central bank's reaction function and in the inflation process respectively. The results are then discussed. Robustness checks employing alternative econometric specifications are reported in the Appendix.

The conclusion summarizes the main findings and implications and suggest areas for future research.

Chapter 1: Inflation in Latin America and the Emergence of Inflation Targeting

1.1 Historical Background

For a long stretch of its modern history, Latin America suffered inflation to an extent that few other regions did. Rapid and extreme price increases became a defining feature of its economies. Such a phenomenon was the consequence of a mix of fragile macroeconomic conditions, including weak institutions struggling to fulfil their mandate, and the constant impact of external shocks. Up until the early 1990s, the region regularly posted the highest inflation rates in the world. Triple digit inflation wasn't unusual, and in several countries, it spiralled into hyperinflation. That provides some insight about how weak monetary institutions were and how little they could do to anchor expectations or provide a stable reference point for prices. Fiscal pressures, indexation practices that kept inflation alive, and the repeated failure of exchange rate stabilization plans all contributed to a situation in which inflation became part of the economic landscape and extremely hard to dislodge.¹

The situation began to change in the early 1990s. A number of countries introduced reforms that, considered together, marked a real break from the past. A substantial departure from past policies was implemented by the region, a situation which leased several countries to reach, for the first time in decades, low inflation rates (below 10%, except Venezuela and Mexico) by the end of the 1990s, similar to those of developed countries. This transformation was particularly encouraged by a new generation of policymakers, often schooled in advanced degrees in the United States and Europe, who propagated a set of principles centred on the long-run neutrality of monetary policy, the high social and economic costs of inflation, and the need for credible institutions to anchor expectations. This intellectual evolution was particularly accompanied by structural changes in trade liberalization, financial liberalization, and the strengthening of central banks' mandates. The culmination of this process is represented by the adoption of

¹ Corbo, V., & Schmidt-Hebbel, K. (2001), *Inflation Targeting in Latin America*. Banco Central de Chile.

inflation targeting frameworks in countries such as Chile, Brazil, Colombia, Mexico and Peru. This provided a transparent and forward-looking mechanism for guiding expectations and enhancing monetary credibility.

However, empirical evidence shows that Latin America's long-term growth performance has been limited by weak productivity dynamics rather than by insufficient accumulation of capital and labour. The region's development trajectory has been reassessed over the past fifty years, and it shows that total factor productivity has remained stagnant, without any evidence of convergence towards the technological frontier. Usually, Latin American economies operate at half the productivity level of the United States, and this gap has shown little signs of constricting.² The stagnation of productivity reflects deeper structural problems: limited technological diffusion, inefficient resource allocation, and a productive structure characterized by heterogeneity and predominance of low-productivity firms.

Recent analyses confirmed that the growth that Latin America is experiencing is explained by these structural constraints. According to the United Nations Development Programme, Latin America grows at a rate around 0.7 percentage points per year slower than similar economies, with nearly the whole gap due to poor productivity rather than differences in investment and human capital formation. High inequality levels exacerbate this phenomenon by limiting social mobility, thereby decreasing the motivation for innovation and hindering the transfer of skills and technologies. Additional evidence from the CAF's regional productivity assessment reinforces this diagnosis. Despite improvements in education, labour participation, and capital deepening, productivity growth has remained flat or negative in several countries.³ The region's productive structure is dominated by firms that operate far from the technological frontier, facing limited competitive pressure and weakly integration into global value chains. These features have rendered Latin American economies particularly vulnerable to external shocks, especially to commodity price shocks. Moreover, those aspects limited the ability

² Fernández-Arias, E., & Fernández-Arias, N. (2021). *The Latin American growth shortfall: Productivity and inequality*. UNDP.

³ Rodríguez-Apolinar, S., & Fernández-Arias, E. (2016). *The Productivity Gap in Latin America: Lessons from 50 Years of Development*. IDB.

of policymakers to operate in a macroeconomic environment characterized by robust and predictable potential growth.

The persistence of these structural weaknesses has become apparent in the post-pandemic period. According to Berganza (2024), output gaps in the major Latin American economies have largely closed not due to a pick-up in productivity growth, but rather to the cyclical recovery following the pandemic and the normalization of domestic demand.⁴ While inflation has recently begun to decline, this process has been gradual, especially in the services sector. The recent round of monetary policy easing in the region was accompanied by a macroeconomic environment in which inflation expectations have been firmly anchored, but at the same time, the region's growth potential was modest and limited by structural productivity issues.

This provides the context for understanding the argument of this chapter, which posits that these years represent a turning point in the macroeconomic history of Latin America. In fact, by 2016, when Argentina tried to impose a target on inflation, the economies of Latin America that adopted inflation targeting regimes in previous years had already reached a greater level of institutional maturity in their monetary institutions, with central banks having gained greater levels of credibility, inflation expectations becoming increasingly anchored, and monetary policy frameworks becoming increasingly transparent and countercyclical.⁵ At the same time, the commodity super cycle was over, and Latin America was forced to address the structural weaknesses inherent in the growth models of the region, which for decades had been heavily dependent on favourable external terms of trade. As a result, the coincidence of credible monetary institutions and deteriorating structural fundamentals created a new macroeconomic environment in which inflation was persistently low and stable and in which growth potential was increasingly limited by productivity stagnation.⁶ This duality of strong monetary institutions and structural weaknesses defines the post-2016 environment and provides the context for the issues analysed in the following sections of this thesis.

⁴ Banco de España (2024). *Report on the Latin American Economy. First Half of 2024*.

⁵ Corbo & Schmidt-Hebbel, *supra* note 1.

⁶ Banco de España (2024), *supra* note 4.

1.2 Latin America's Reaction to Inflation Targeting

Inflation targeting is a monetary policy tool that involves the commitment of the central bank to an objective inflation rate and the implementation of policies that are informed by the assessment of the current and future state of the economy. As such, the framework of inflation targeting is premised on the principles of transparency and communication, and the central bank must operate in an environment that allows for its independence. The adoption of an inflation targeting framework represents not only an approach for disinflation, but also an overarching framework that alters the practice of monetary policy.⁷

Inflation targeting policies in Latin America came right after a larger macroeconomic change that took place in the late 1980s and early 1990s. Over the two decades that followed, regional inflation fell from an average of about 168% in the 1980s to around 5.6% in the 2010s.⁸ This decline was structural rather than cyclical. As such, it rested on a broader programme of reforms designed to raise the region's competitiveness. However, the adoption of the fixed exchange rate regime was insufficient, particularly in the long term, to reach the target.⁹ The region experienced the collapse of the currency in the 1980s and the 1990s, which underscored the fact that the fixed exchange rate regime was not sustainable in the region.

A decisive step toward inflation targeting was the institutional strengthening of central banks during the 1990s. For the region as a whole, there was the imposition of prohibitions on the use of financial support for budgetary deficits, the adoption of price stability as the primary objective, and the establishment of governance arrangements that are designed to insulate central banks from political pressures.¹⁰ There was also a notable rise in the Central Bank Independence Index for the region during this period, highlighting the region-wide effort to establish an effective monetary system. The developments in the region's institutional framework are consistent with the findings of Jácome and Pienknagura (2022), showing that higher central bank independence is

⁷ Corbo & Schmidt-Hebbel, *supra* note 1.

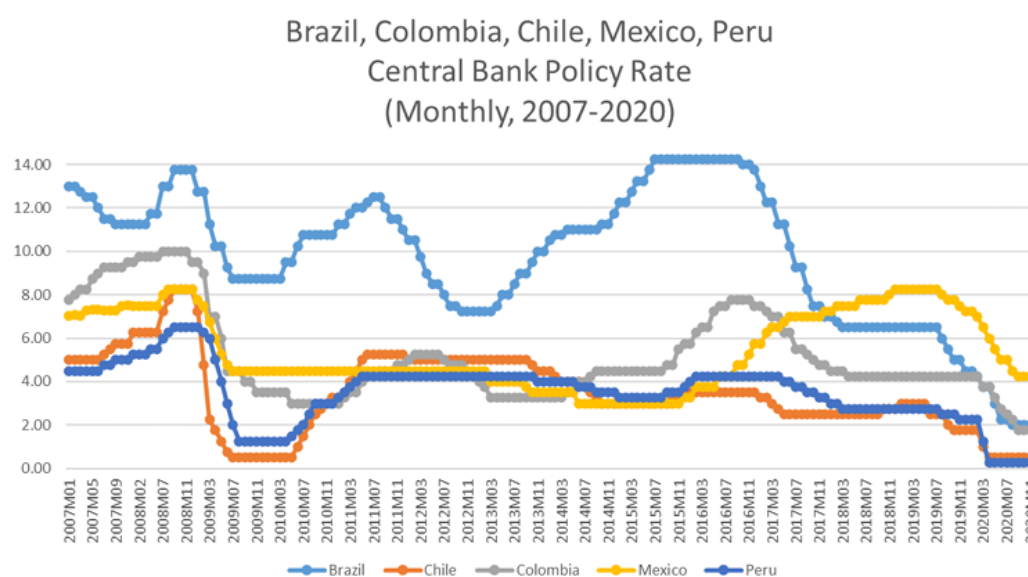
⁸ Werner, A. (2023). *Central banking in the Americas: Lessons from two decades*. Bank for International Settlements (BIS).

⁹ Corbo, V., Elberg, A., & Tessada, J. (1999). Monetary policy in Latin America: Underpinnings and procedures. *Cuadernos de Economía*.

¹⁰ Werner, *supra* note 8.

closely linked to lower rates of inflation and the reduced likelihood of high rates of inflation. The results of their study suggest that a one-standard-deviation rise in central bank independence is followed by a 10% drop in the price level after five years, thus highlighting the economic significance of central bank independence.¹¹

For the new monetary regime, the issue of credibility became very important. With greater independence and clearer mandates, Latin American central banks adopted forward looking policy rules, improved communication, building reputational capital.¹² As a result, inflation expectations in the region became more stable and less sensitive to short term shocks. This credibility enabled the region to implement countercyclical monetary policy for the first time. During the Global Financial Crisis and the COVID 19 recession, policy rates were reduced aggressively, as shown in *Graph 1*, marking a clear departure from the procyclical tightening that had characterized earlier decades.¹³ The ability to respond countercyclically reflects the core advantage of inflation targeting: it provides a nominal anchor that does not rely on defending an exchange rate parity, thereby allowing monetary policy to react to domestic conditions.



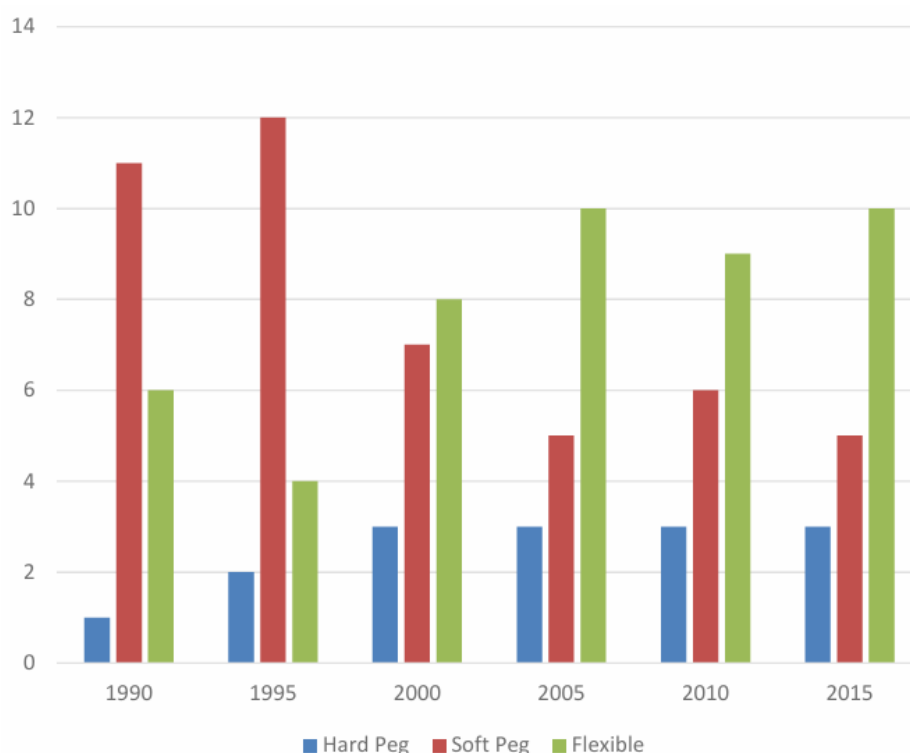
Graph 1. Brazil, Colombia, Chile, Mexico, Peru: Central Bank Policy Rate. Source: Werner, A. (2023). Central banking in the Americas: Lessons from two decades. BIS Papers No. 143, Bank for International Settlements.

¹¹ Jácome, L. I., & Pienknagura, S. (2022). *Central bank independence and inflation in Latin America—Through the lens of history* (IMF Working Paper WP/22/186). International Monetary Fund (IMF).

¹² Schmidt-Hebbel, K., & Carrasco, M. (2019). *Central banking in Latin America*. In *The New Palgrave Dictionary of Economics*. Palgrave Macmillan.

¹³ Werner, supra note 8.

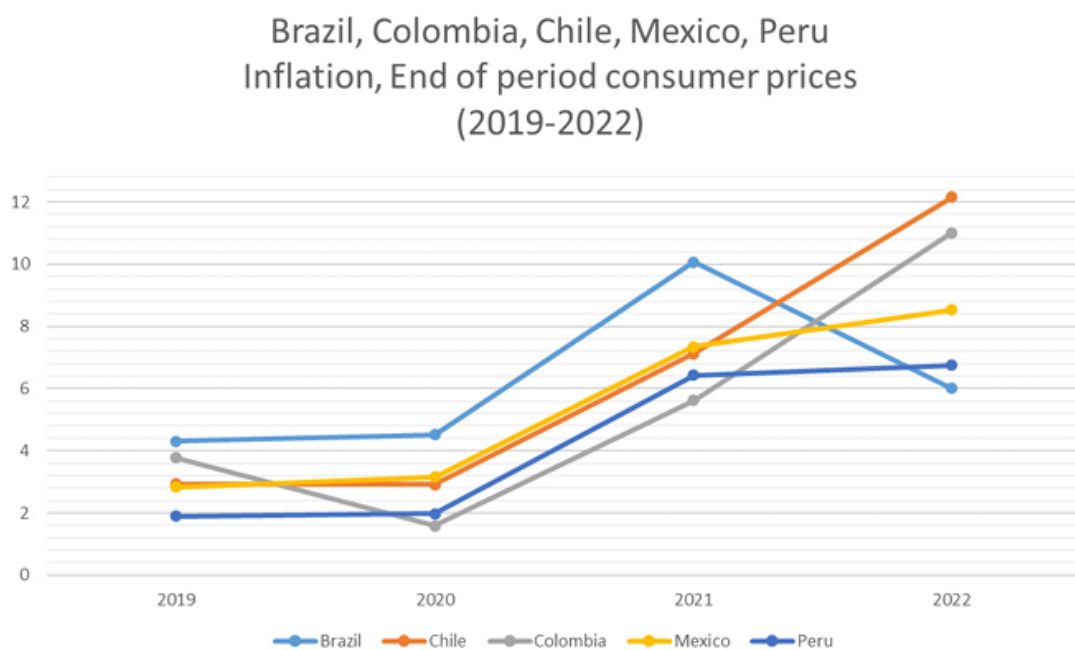
Although the region converged toward inflation targeting, the transition paths differed significantly across countries. Chile and Colombia took the slow route, widening their exchange rate bands step by step before letting the currency float. This gave their central banks time to build credibility. Mexico and Brazil had no such option: their floating regimes were forced by the currency crises of 1994 and 1999. In both cases, inflation targeting was the only available nominal anchor with the failure of fixed exchange rate systems. Despite the turbulent transition experience in Mexico and Brazil, both countries succeeded in building robust systems of inflation targeting. Peru is a case apart. The economy is still heavily dollarized, so the central bank lets the currency float but intervenes often to keep volatility low. Large reserves and a credible policy record make this possible. The diversity of these trajectories is reflected in *Graph 2*, which documents the region wide shift from hard and soft pegs to flexible regimes between 1990 and 2015.



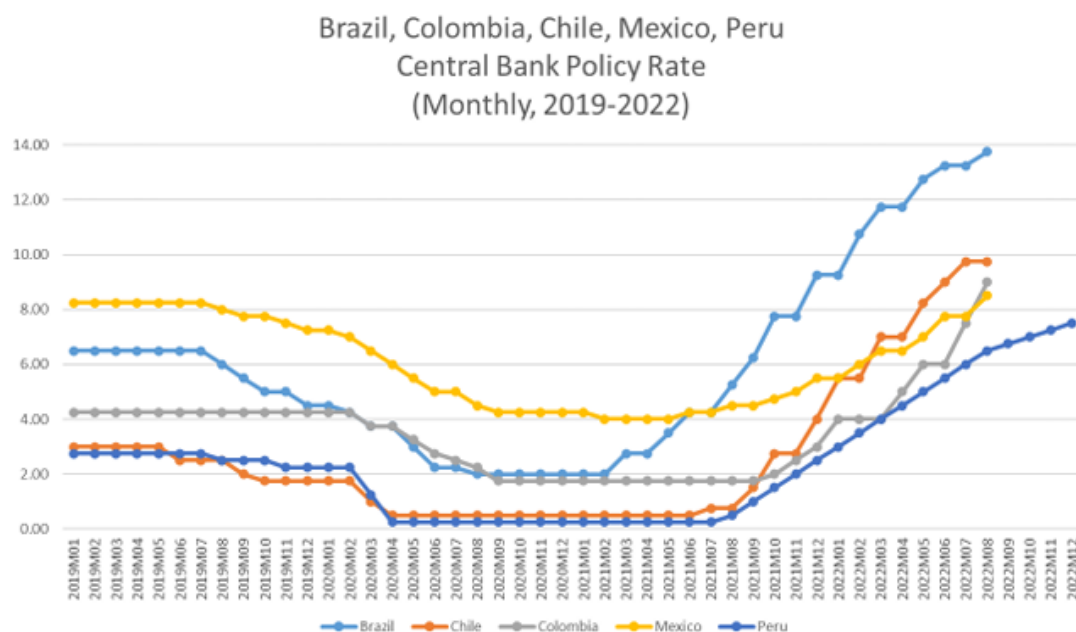
Graph 2. Exchange rate regimes in Latin America: Number of countries. Source: Werner, A. (2023). *Central banking in the Americas: Lessons from two decades*. BIS Papers No. 143, Bank for International Settlements.

The effectiveness of inflation targeting as a nominal anchor became particularly evident during the inflationary shock of 2021–2022. According to *Graph 3*, the rate of inflation in the major economies of the region has risen from the 2-4% band in 2019 to the 7.5-12% band in 2022. This rise in the rate of inflation has been fuelled by global supply

chain disruptions and domestic demand pressures. However, despite the escalation of the rate of inflation in the region, the inflationary expectations have remained anchored. Moreover, the central banks of the countries in the region have reacted swiftly, and Brazil has led the tightening cycle, as depicted in *Graph 4*. This shows that the countries in the Latin American region have the ability to react swiftly and credibly in the face of global shocks. This proves the superiority of the inflation targeting regime as the nominal anchor of the macroeconomic environment of countries that face volatile global economic conditions. Unlike the fixed exchange rate regime, which forces the monetary policymakers of the countries in the Latin American region to focus solely on defending the exchange rate, the inflation targeting regime allows the central banks of the countries in the region to vary the interest rates in line with the domestic economic conditions while maintaining the commitment to price stability.



Graph 3. Brazil, Colombia, Chile, Mexico, Peru: Inflation, End of period consumer prices. Source: Werner, A. (2023). *Central banking in the Americas: Lessons from two decades*. BIS Papers No. 143, Bank for International Settlements.



Graph 4. Brazil, Colombia, Chile, Mexico, Peru: Central Bank Policy Rate. Source: Werner, A. (2023). *Central banking in the Americas: Lessons from two decades*. BIS Papers No. 143, Bank for International Settlements.

Thus, the introduction of the inflation targeting system in the Latin American region could be seen as a paradigmatic shift in the macro environment of the constituent nations. Though the rate and extent of this shift may vary across nations in the region, it is pertinent to note that the five most dominant nations in this region who have adopted this inflation targeting policy are: Brazil, Chile, Colombia, Mexico, and Peru. These nations have adopted a macro environment that is significantly more consistent and credible in comparison to other monetary policy regimes.

Furthermore, it is also pertinent to note that the macro experience of Latin American nations during the last two decades, and more specifically during the Global Financial Crisis, COVID-19 Pandemic, and Inflation Shock in 2021-2022, also proves the relative superiority of this inflation targeting policy as the most dominant monetary policy in this region in comparison to other nations who did not adopt such institutional reforms in their respective macro environments, such as Argentina and Venezuela.¹⁴

¹⁴ Schmidt-Hebbel, K., & Carrasco, M., supra note 12.

1.3 Monetary Policy Reaction: Consistency with the Taylor Rule

A significant change was brought to the monetary policy of Brazil, Chile, Colombia, Mexico, and Peru due to the implementation of the inflation targeting regime in the late 1990s and early 2000s. This practice has fundamentally changed the way monetary policy is conducted, as it is now more closely aligned to a well-specified response function. The most commonly used measure of the change brought to the monetary policy is the Taylor Rule, which describes the reaction function of the monetary institution, and it can represent a framework for evaluating whether or not the central banks were responding sufficiently to stabilize expectations and ensure initial regime credibility.

In its standard form, the Taylor Rule can be expressed as:

$$i_t = r^* + \pi_t + \alpha(\pi_t - \pi^*) + \beta(y_t - y^*)$$

where i_t denotes the policy rate, r^* the neutral real interest rate, π_t current inflation, π^* the inflation target, and $y_t - y^*$ the output gap. The parameters α and β measure the intensity of the central bank's response to inflation and real activity respectively. A key condition for macroeconomic stability is the Taylor Principle, which requires $\alpha > 1$, ensuring that real interest rates rise when inflation increases. In practice, most inflation-targeting central banks also incorporate interest rate smoothing, represented by:

$$i_t = \rho i_{t-1} + (1 - \rho)[r^* + \pi_t + \alpha(\pi_t - \pi^*) + \beta(y_t - y^*)]$$

with $0 < \rho < 1$, reflecting the gradual adjustment of policy rates to avoid excessive volatility.

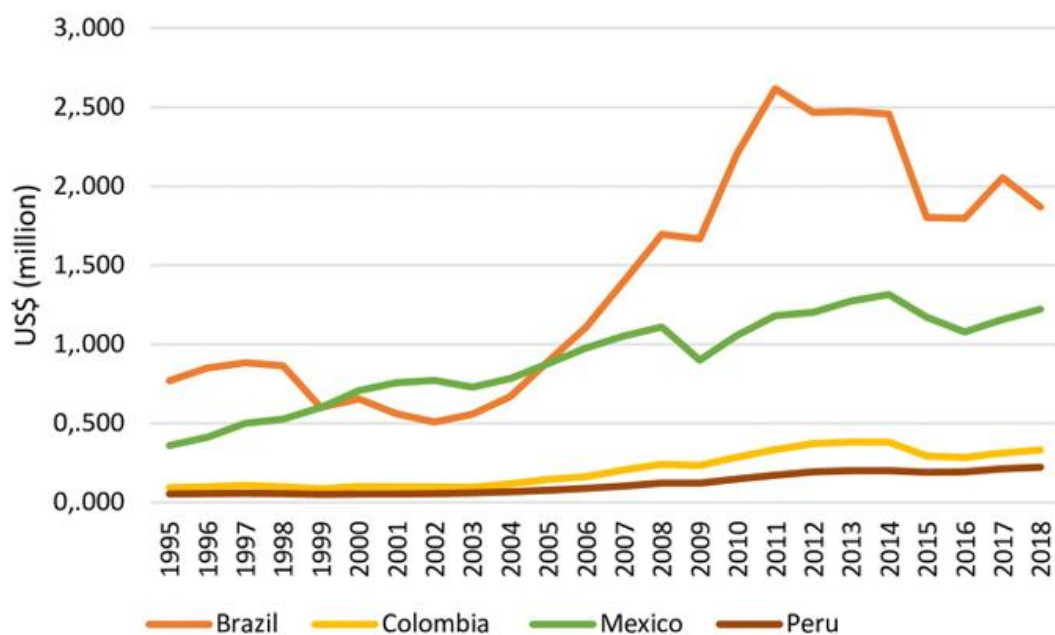
Empirical estimates for the early inflation-targeting period show that the five Latin American central banks generally reacted in a manner consistent with the Taylor Principle. Inflation coefficients were typically around 1.5 in Mexico, between 1.2 and 1.4 in Chile, and close to 1.0–1.2 in Brazil and Colombia, while Peru displayed more moderate values, often below one.¹⁵ These results indicate that most central banks responded more than proportionally to inflation deviations, internalizing a rule-based

¹⁵ Moura, M. L., & de Carvalho, A. (2010). What can Taylor rules say about monetary policy in Latin America? *Journal of Macroeconomics*, 32, 392–404.

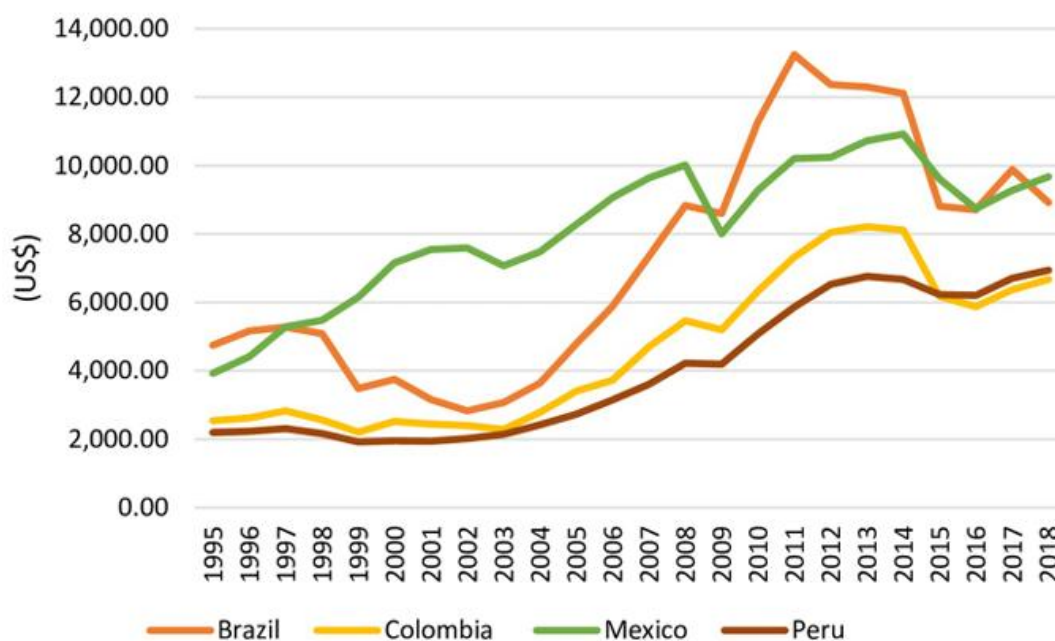
approach even if the strength of the reaction varied across countries. Output-gap coefficients were smaller, usually between 0.1 and 0.5, consistent with the priority assigned to price stability during the early phase of inflation targeting.

The process of monetary policy during this period is illustrated through a series of graphs showing the path of some macroeconomic variables from 1995 to 2018.¹⁶ *Graph 5* plots the evolution of output growth, inflation, and policy rates for Brazil, Colombia, Mexico, and Peru. The picture provided is one of a strong decline in inflation and a gradual move towards stability in policy rates following the adoption of inflation targeting. The behaviour of inflation and interest rates becomes more regular over time, with tightening cycles in Mexico and Chile particularly closely following inflation. *Graph 6* presents the estimated response of policy rates to inflation using ARDL specifications. The slope of the reaction curve is steeper in countries with stronger anti-inflationary stances, confirming the higher values of α found in the estimates. *Graph 7* identifies distinct monetary policy regimes through a Markov-switching model. It reveals prolonged periods of high responsiveness in Mexico and Chile, while Brazil and Colombia alternate more frequently between high and low responsiveness regimes, reflecting political cycles and the influence of external shocks.

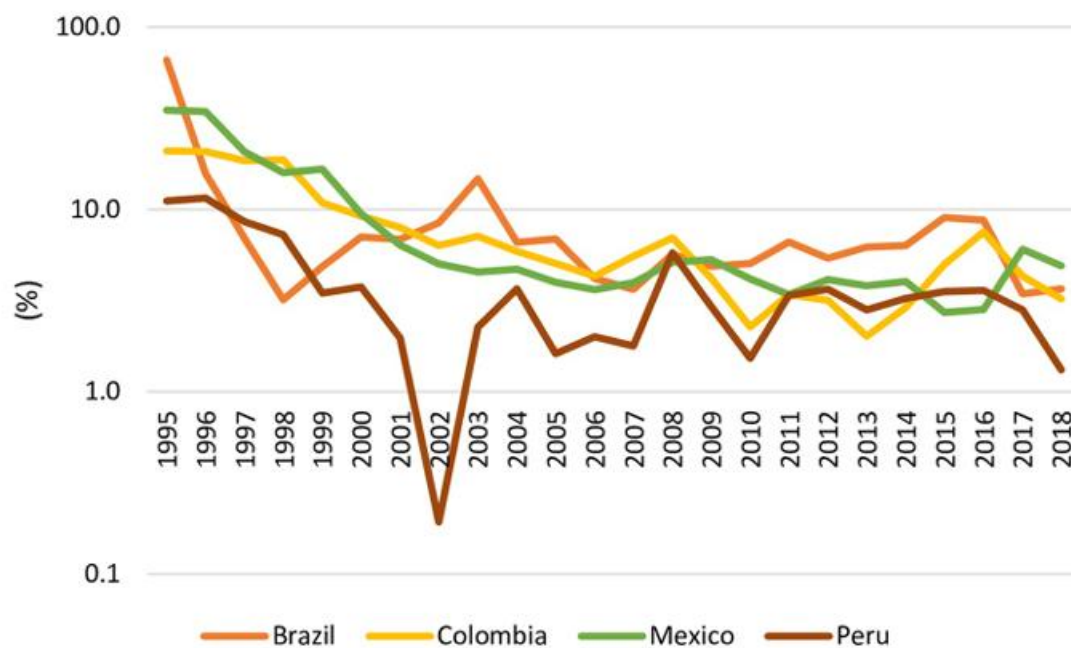
¹⁶ Menezes Nery de Oliveira, N. S., & Mourão, P. R. (2021). Taylor's rule, political cycle, and Latin America—An analysis of time series in search of responsibility for monetary stabilization. *PLOS ONE*, 16(12), e0259314.



Graph 5. Gross Domestic Product at current prices (1995–2018). Source: Menezes Nery de Oliveira, N. S., & Mourão, P. R. (2021). Taylor's rule, political cycle, and Latin America: An analysis of time series in search of responsibility for monetary stabilization. *PLOS ONE*, 16(12), e0259314.



Graph 6. Gross Domestic Product per capita at current prices (1995–2018). Source: Menezes Nery de Oliveira, N. S., & Mourão, P. R. (2021). Taylor's rule, political cycle, and Latin America: An analysis of time series in search of responsibility for monetary stabilization. *PLOS ONE*, 16(12), e0259314.



Graph 7: Inflation rates, yearly (1995–2018). Source: Menezes Nery de Oliveira, N. S., & Mourão, P. R. (2021). *Taylor's rule, political cycle, and Latin America: An analysis of time series in search of responsibility for monetary stabilization*. *PLOS ONE*, 16(12), e0259314.

In open economies such as Colombia and Peru, exchange rate dynamics play a central role in shaping the reaction function.¹⁷ When the Taylor Rule is augmented to include exchange rate depreciation, the additional coefficient is positive and statistically significant, indicating that policy rates tend to rise in response to currency depreciation to limit inflationary pass-through. Such a trend is in line with the structural characteristics of the Latin American economies, in which exchange rate volatility has historically been a significant driver of prices in the region.

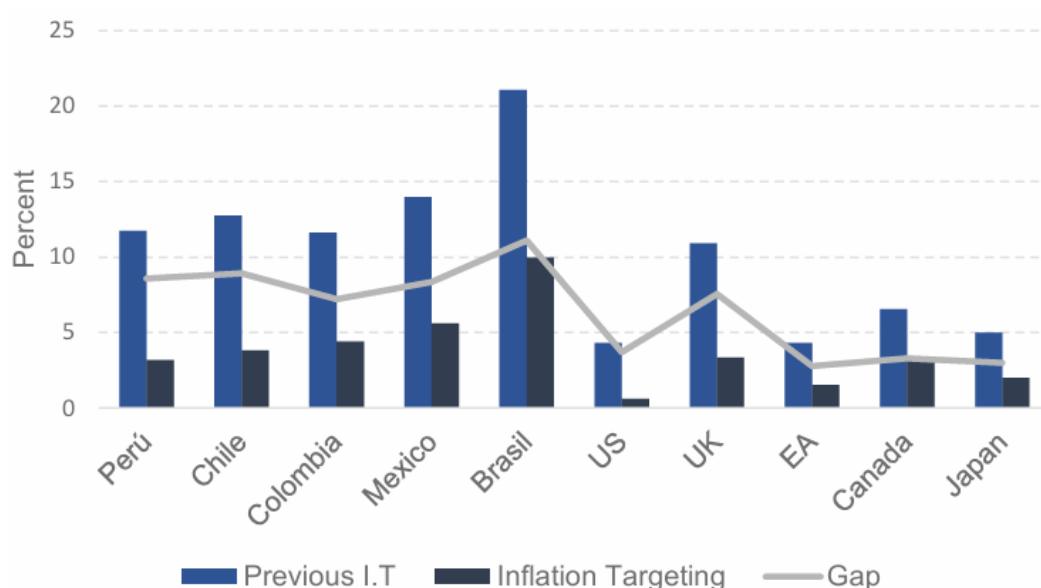
Moreover, if a further analysis is carried out on other emerging economies, a non-linear response is noted with respect to monetary policy, where reactions to inflation increase with levels of inflation beyond certain thresholds, owing to the need for maintaining credibility in environments with high levels of external vulnerability, a trend consistent with the experience of Chile and Mexico in the early 2000s.¹⁸ Although non-linearities

¹⁷ Guerra, R., Kamin, S., Kearns, J., Upper, C., & Vakil, A. (2024). *Latin America's non-linear response to pandemic inflation* (BIS Working Paper No. 1209). Bank for International Settlements (BIS).

¹⁸ Caporale, G. M., Helmi, M. H., Çatık, A. N., Menla Ali, F., & Akdeniz, C. (2018). Monetary policy rules in emerging countries: Is there an augmented nonlinear Taylor rule? *Economic Modelling*, 72, 306–319.

became more pronounced during the post-pandemic inflation surge,¹⁹ this development represents a continuation rather than a departure from earlier behaviour.

The macroeconomic environment of the early inflation-targeting years also contributed to shaping reaction functions. *Graph 8* shows a clear structural break between the pre and post-inflation targeting periods.²⁰ After the adoption of the regime, both nominal and real rates declined significantly, reflecting improved credibility and lower inflation expectations. This decline, however, did not reflect a decrease in policy responsiveness, but rather a decrease in the neutral real rate and a more stable macroeconomic environment.



Graph 8. Interbank rate estimation under inflation targeting and previous regimes. Source: Chi3n-Chac3n, S. J., & 3lvarez Garc3a, K. A. (2025). Decline of interest rates under inflation targeting and previous regimes: Evidence from Latin America and developed countries. *Econom3a Chilena*, 8(1), 5–30.

The robustness of inflation targeting is further underscored by the response to the 2008 global financial crisis.²¹ Although the framework was unchanged, some countries altered their response functions. Mexico raised its sensitivity to the output gap, Chile reacted more quickly to inflation shocks, and Brazil showed limited response. These adjustments reflect evolving economic conditions rather than a departure from rule-based policy.

¹⁹ See Guerra, R., Kamin, S., Kearns, J., Upper, C., & Vakil, A., supra note 17.

²⁰ Chi3n-Chac3n, S. J., & 3lvarez Garc3a, K. A. (2025). Decline of interest rates under inflation targeting and previous regimes: Evidence from Latin America and developed countries. *EconStor*.

²¹ Mondino, T. J. (2012). *Inflation targeting in Latin America: Did anything change after the crisis?* (Undergraduate honours thesis). Amherst College, Economics Department.

A structural analysis of the Taylor Rule for Latin American economies reveals difficulties stemming from high exchange rate pass-through effects, contractionary depreciations, and low interest rate elasticity of demand.²² In these contexts, a rigid application of the Taylor Rule can lead to high output volatility and may explain why some central banks in Latin American countries, such as Peru, complement interest rate policies with exchange rate interventions to stabilize the economy.

Moreover, the underlying rationale for monetary policy responses is complemented by long-run evidence on central bank independence.²³ Long-run graphs covering over a hundred-year document that increases in central bank independence are associated with large reductions in inflation. To be more precise, a one-standard-deviation increase in central bank independence corresponds with a 10%-point decline in inflation over a five-year window. Central bank independence is a crucial component of the Taylor Rule because only autonomous central banks are likely to react to deviations in the target inflation rate.

Overall, it is possible to conclude that Taylor Rule framework of monetary policy in Brazil, Chile, Colombia, Mexico, and Peru broadly aligns since the implementation of inflation targeting. Central banks in these countries have met the Taylor principle, implemented interest rate smoothing, and adjusted to changes in their structural conditions. While political factors, exchange rate shocks, and structural factors remain an important part of these economies' policy processes, the Taylor Rule framework appears to have shown considerable resiliency, paving the way for the comparative analysis of the Argentine experience in the next chapter.

1.4 Evolution of the Phillips Curve in the Inflation Targeting Era

The adoption of inflation targeting in Latin America between the late 1990s and the early 2000s broke with the region's earlier pattern of chronic inflation, fragile monetary institutions and volatile inflationary expectations. As central banks gained independence,

²² Libman, E. (2022). Is inflation targeting destabilizing? Lessons from Latin America. *Brazilian Journal of Political Economy*, 42(2), 304–326.

²³ Jácome, L. I., & Pienknagura, S., *supra* note 11.

refined their communication, and bound themselves to explicit numerical targets, the empirical shape of the Phillips Curve changed accordingly. The IT era did not eliminate the PC; rather, it reshaped it by flattening its slope, altering its identification, and increasing the role of expectations and external shocks in driving price dynamics.

The key insight is based on work by McLeay and Tenreyro (2019) where they show that when optimal monetary policy is implemented, the correlation between inflation and slack in the reduced form becomes inherently insignificant.²⁴ This occurs because, through systematic response to demand shocks in order to stabilise inflation, inflation becomes cost-push like in nature. This mechanism is particularly relevant for Latin America, where IT frameworks were explicitly designed to minimise welfare losses from inflation deviations. The apparent “disappearance” of the PC in empirical data is therefore not evidence of its structural absence, but a consequence of successful stabilisation.

The evolution of credibility is central to understanding how the PC changed in the region. Gießler shows that Latin American central banks gradually transitioned from backward-looking to forward-looking policy rules as credibility improved.²⁵ In the early years of IT, monetary authorities reacted simultaneously to actual and expected inflation; as expectations became better anchored, policy became increasingly forward-looking, reducing the sensitivity of inflation to domestic slack. This change is consistent with the broader literature on expectation anchoring in emerging markets, which points to the stability of long-run expectations in Latin America, although these have certainly been more volatile than those in advanced economies, becoming more stable during the 2000s.²⁶

Chile represents a particularly illustrative case. As an early adopter of information technology in the region (1999), the Central Bank of Chile quickly developed a reputation for its consistency and transparency. Although the literature does not provide the same depth of regional Phillips Curve estimates for Chile as for Brazil or Mexico, the country’s inflation dynamics exhibit the hallmark features of a credible IT regime: low persistence,

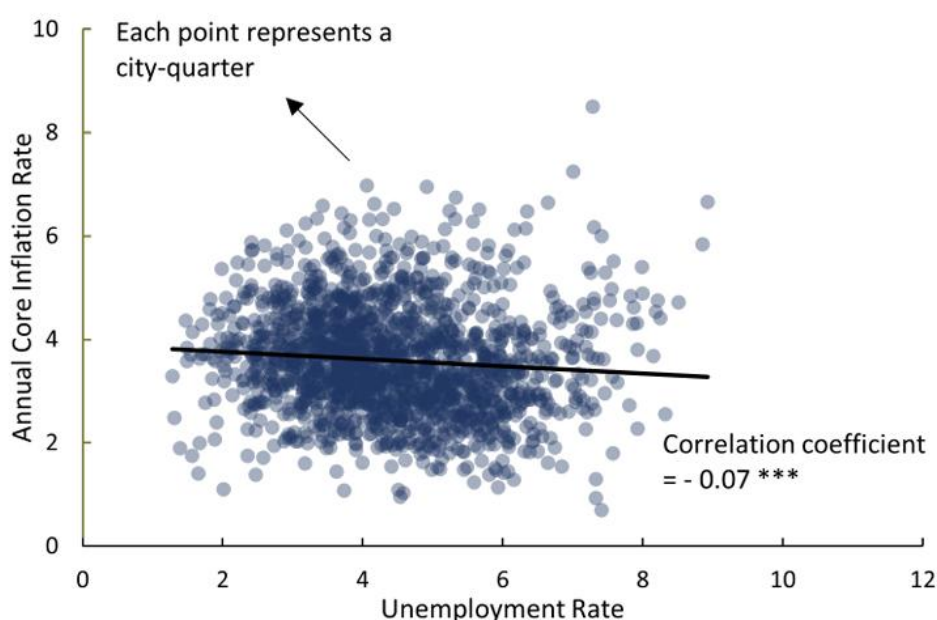
²⁴ McLeay, M., & Tenreyro, S. (2019). *Optimal inflation and the identification of the Phillips curve* (NBER Working Paper No. 25892). National Bureau of Economic Research (NBER).

²⁵ Gießler, S. (2020). *The evolution of monetary policy in Latin American economies: Responsiveness to inflation under different degrees of credibility* (IWH Discussion Paper No. 9/2020). Halle Institute for Economic Research (IWH).

²⁶ Federal Reserve Board. (2024). *How well-anchored are long-term inflation expectations in Latin America?* FEDS Notes, Board of Governors of the Federal Reserve System.

limited pass through, and a strong expectations channel. Chile’s experience reinforces the idea that credibility, rather than structural labour market features alone, plays a decisive role in shaping the slope of the PC.

Country-level evidence reinforces this narrative. In Mexico, the adoption of IT in 2001 and the consolidation of central bank autonomy produced a marked decline in inflation persistence, exchange-rate pass-through, and expectation dispersion.²⁷ Regional-level estimates by Aldeco and Reyes confirm the existence of a statistically significant PC, but with a relatively weak slope: a 1-percentage-point increase in unemployment reduces core inflation by only 0.18 percentage points.²⁸ Their scatter plot of city-level inflation and unemployment in *Graph 9* illustrates the muted slope.



Graph 9. City-level annual core inflation and unemployment rate. Source: Aldeco Leo, L., & Reyes Rocha, H. (2025). *An estimation of the Phillips curve in Mexico using city level data*. Banco de México Working Paper.

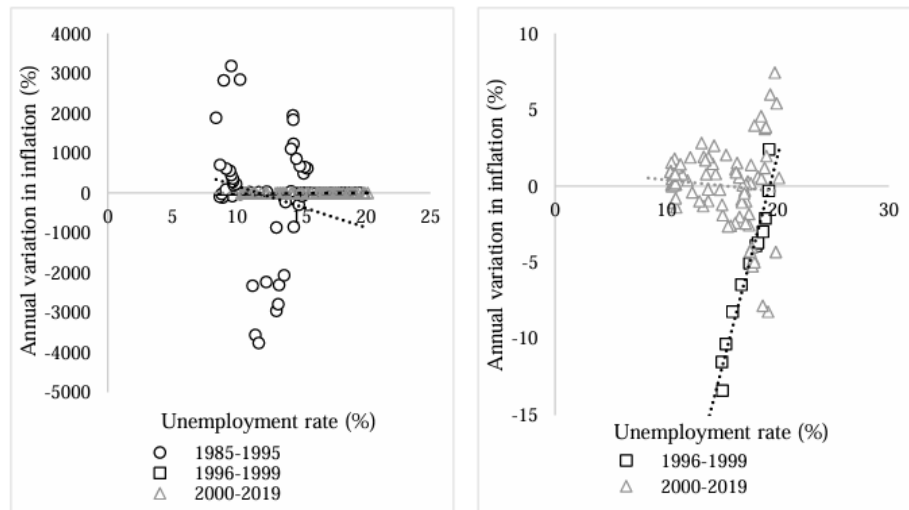
This muted sensitivity reflects Mexico’s labour market structure, characterised by high informality and flexible margins of adjustment, which allows the economy to absorb demand shocks without generating strong inflationary pressures.²⁹

²⁷ Rodríguez, V., Cuadra, G., & Sámano, D. (2023). *Inflation targeting in Mexico: Evolution, achievements and policy lessons*. Bank for International Settlements.

²⁸ Aldeco Leo, L., & Reyes Rocha, H. (2025). *An estimation of the Phillips curve in Mexico using city level data*. *EconStor*.

²⁹ Leyva, G., & Urrutia, C. (2020). Informality, labor regulation, and the business cycle. *Journal of International Economics*, 126, 103349.

In Brazil, the PC also flattened substantially after the introduction of IT in 1999. Fernandes and Portugal, using a multi-region model with time-varying parameters, show that the slope of the PC declined sharply during the transition from the crawling-peg regime to IT.³⁰ The authors attribute this flattening to two forces: (i) improved anchoring of expectations, which limits the propagation of shocks into inflation, and (ii) structural changes such as trade liberalisation and increased competition, which reduce firms' pricing power. Their findings echo the broader international literature suggesting that globalisation and institutional reforms weaken the inflation–slack relationship. As shown in *Graph 10*, the slope shifts from -103.84 (1985–1995) to -0.075 (2000–2019), a reduction of four orders of magnitude, consistent with stronger expectations anchoring and structural reforms.



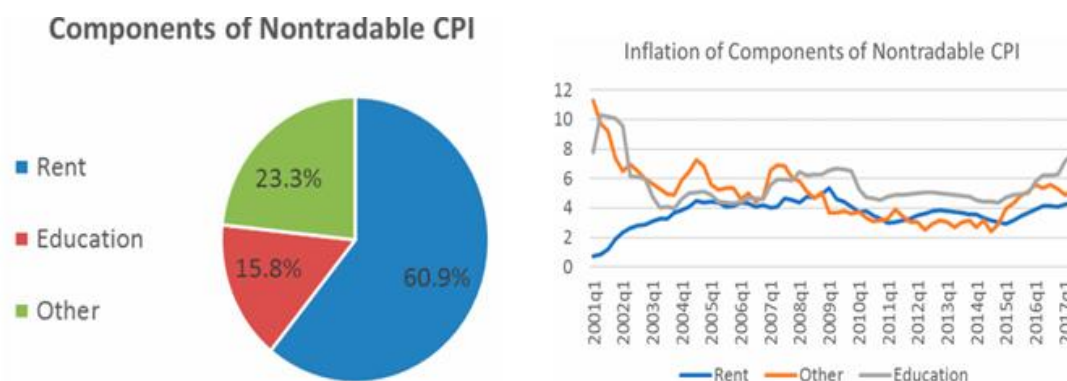
Graph 10. Accelerationist Phillips Curves for Brazil in the period 1985–2019. Source: Fernandes, G. S., & Portugal, M. S. (2023). Flattening of the Phillips Curve in Brazil after Inflation Targeting: evidence from a multi-region model with time-varying parameters.

In Colombia, a disaggregated Phillips Curve approach reveals a more nuanced picture. Lanau, Robles and Toscani find that the aggregate PC is relatively flat, but steeper than in the United States.³¹ Tradable and food prices respond strongly to supply shocks, especially exchange-rate movements and weather events, while non-tradables display significant inertia due to indexation practices. The coexistence of a weak aggregate PC

³⁰ Fernandes, G. S. & Portugal, M. S. (2023). *Flattening of the Phillips Curve in Brazil after Inflation Targeting: evidence from a multi-region model with time-varying parameters.*

³¹ Lanau, S., Robles, A., & Toscani, F. (2018). *Explaining inflation in Colombia: A disaggregated Phillips curve approach* (IMF Working Paper WP/18/106). International Monetary Fund (IMF).

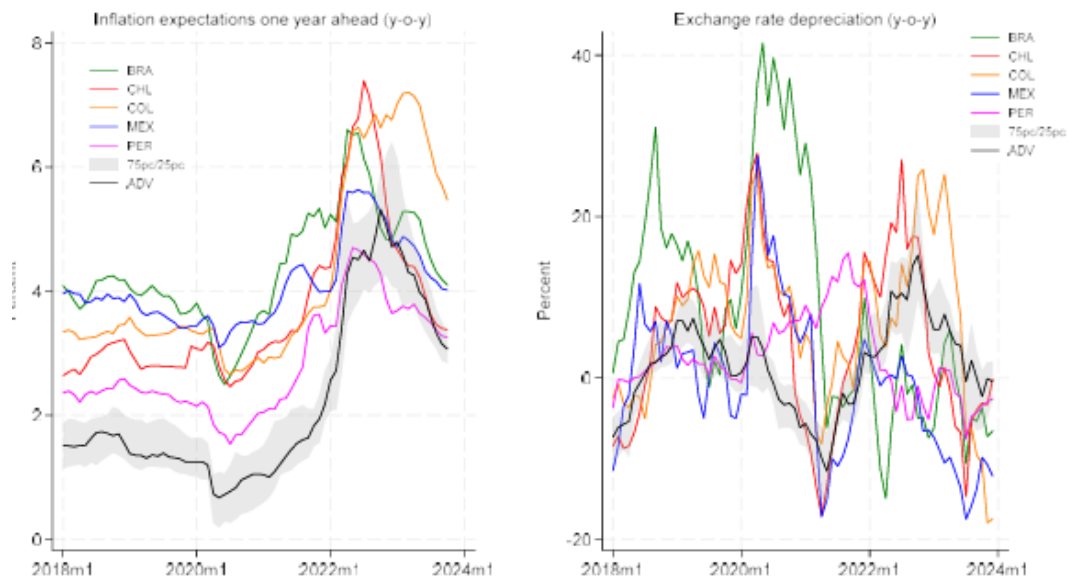
with strong component-level sensitivities highlights the importance of structural heterogeneity in Latin American inflation dynamics. Their scatter plots of slack versus inflation show no clear reduced-form relationship, underscoring the importance of controlling for supply shocks (*Graph 11*).



Graph 11. Components of Non-Tradable Inflation. Source: Lanau, S., Robles, A., & Toscani, F. (2018). Explaining inflation in Colombia: A disaggregated Phillips curve approach. IMF Working Paper WP/18/106, International Monetary Fund.

Recent evidence from the post-COVID inflation episode further illustrates the role of expectations and external shocks. Medina and Wlasiuk show that Latin American inflation accelerated earlier and more intensely than in advanced economies, driven by supply-chain disruptions, exchange-rate depreciation, and rising inflation expectations, as shown in *Graph 12*.³² Monetary policy has reacted with considerable assertiveness, with central banks in Brazil, Chile, Colombia, and Mexico tightening policy earlier and more forcefully than in advanced economies, reflecting greater responsiveness to expectations and external financial conditions. The rapid and front-loaded tightening in Chile, which was one of the earliest in the world, underscored the central bank's commitment to preserving credibility and preventing de-anchoring of expectations.

³² Medina, J. P., & Wlasiuk, J. M. (2024). *Inflation dynamics in Latin America: Lessons from the COVID and other episodes*. Working Paper No. 99. Brookings Institution.



Graph 12. Inflation Expectations and Exchange Rate Depreciation Since 2018. Source: Medina, J. P., & Wlasiuk, J. M. (2024). *Inflation dynamics in Latin America: Lessons from the COVID and other episodes*. Working Paper No. 99, Brookings Institution.

Lastly, the experience of Peru, which was one of the most successful information technology adopters in emerging markets, underscores how robust institutions can stabilize inflation in even partially dollarized economies. Armas shows that Peru's combination of IT, active foreign-exchange intervention, and macroprudential tools significantly reduced exchange-rate pass-through and strengthened the anchoring of expectations.³³ In such a context, the PC becomes flatter not because it ceases to exist, but because monetary policy effectively neutralises the channels through which slack would otherwise influence inflation.

A comprehensive reading of the Latin American experience indicates that the evolution of the Phillips Curve under inflation targeting is best interpreted as a credibility-driven flattening. Even though the underlying micro foundations of the Phillips relationship remain relevant, especially if viewed with the help of regional or disaggregated data, the empirical relationship between inflation and economic slack has diminished with the anchoring of inflation expectations. In this framework, the role of external shocks emerges as a dominant force, especially in countries with high levels of economic openness. At the same time, the role of labour market institutions, including the share of

³³ Armas, A. (2021). *Inflation targeting in a partially dollarized economy: The case of Peru*. Presentation at the "Inflation Targeting in Emerging Economies" workshop, National Bank of Ukraine.

the informal sector, the bargaining power of workers, and the characteristics of the labour force, generates notable cross-country and within-country variations in the slope of the Phillips Curve.

Rather, the Phillips Curve in Latin America has become harder to detect, more heterogeneous, and more conditional on expectations and external conditions, and that is in part because of the maturation of the region's monetary policy.

Chapter 2: Argentina as a Structural Outlier in Latin America

2.1 Institutional and Macroeconomic Background

Argentina began the 2010s as a structural outlier in Latin America. In particular, while Inflation Targeting (IT) systems were introduced between the late 1990s and the early 2000s in Chile, Colombia, Brazil, Mexico, and Peru, Argentina had to face a series of crises. Between them, Argentina experienced significant changes in its economic systems and instability over the last several decades. All these events generated a poor institutional setting, poor public finances, and a monetary system that significantly diverged from those perceived to be necessary for a successful transition to IT. These are extremely important issues for understanding the timing of the introduction of Inflation Targeting in Argentina, which was finally introduced in 2016, as well as for gaining insight into the environment in which IT was successfully implemented in other countries. The monetary system in Argentina made a transition to a more developed one starting from the 80s, when the country experienced hyperinflation. Challenges in Argentina's monetary system were observed during this period, as indicated by increasing inflation rates and peaks at this time.³⁴ *Figure 13* illustrates the trajectory of the Argentine inflation rate from 2000 onwards, with particular focus on the sharp acceleration of the inflation rate after the dissolution of the Convertibility regime.

³⁴ Cavallo, A., & Bertolotto M. (2016). *Filling the Gap in Argentina's Inflation Data*. The Billion Price Project.

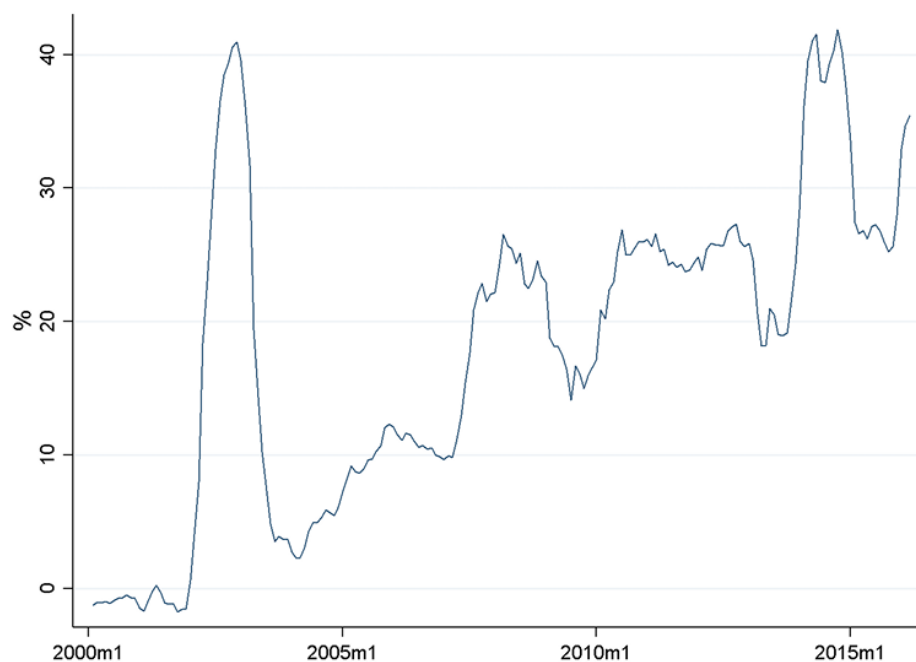


Figure 13. Inflation rate in Argentina from 2000. Source: Cavallo, A., & Bertolotto, M. (2016). *Filling the Gap in Argentina's Inflation Data*. The Billion Price Project.

The Convertibility Plan, which was in place from 1991 to 2001, provided temporary price stability through a dollarization policy, hence by pegging the domestic currency to the US dollar at a one-to-one exchange rate. However, the institutional foundation that was built into the exchange rate regime was fundamentally incompatible with the principles of inflation targeting. The failure of the dollarization in 2001-2002 led to a default, a financial crisis, and the imposition of a forced conversion of all dollar-denominated deposits, loans, and contracts into pesos. This measure is commonly referred to as “pesification”. This policy, which aimed to prevent a systemic banking crisis, resulted in significant balance-sheet distortions, a loss in confidence, and a regime risk effect on prices and expectations. During the 2000s and in the early 2010s, Argentina implemented discretionary and heterodox policies, including price controls, capital controls, and manipulating inflation data, which have been extensively documented by various international organizations.³⁵ These features made it impossible to implement the transparency, credibility, and institutional autonomy required for IT.

³⁵ The Economist. (2014). *Don't lie to me, Argentina*.

The legacy of recurrent macroeconomic crises further shaped Argentina's pre-2016 environment. The estimates of the output gaps for the period 2007-2015 reveal considerable volatility, and the lack of ability to sustain long periods of stable economic growth underscores the sensitivity of the economy to external and internal policy changes.³⁶ Figure 14 compares potential output and the estimated output gap and makes this point visually.

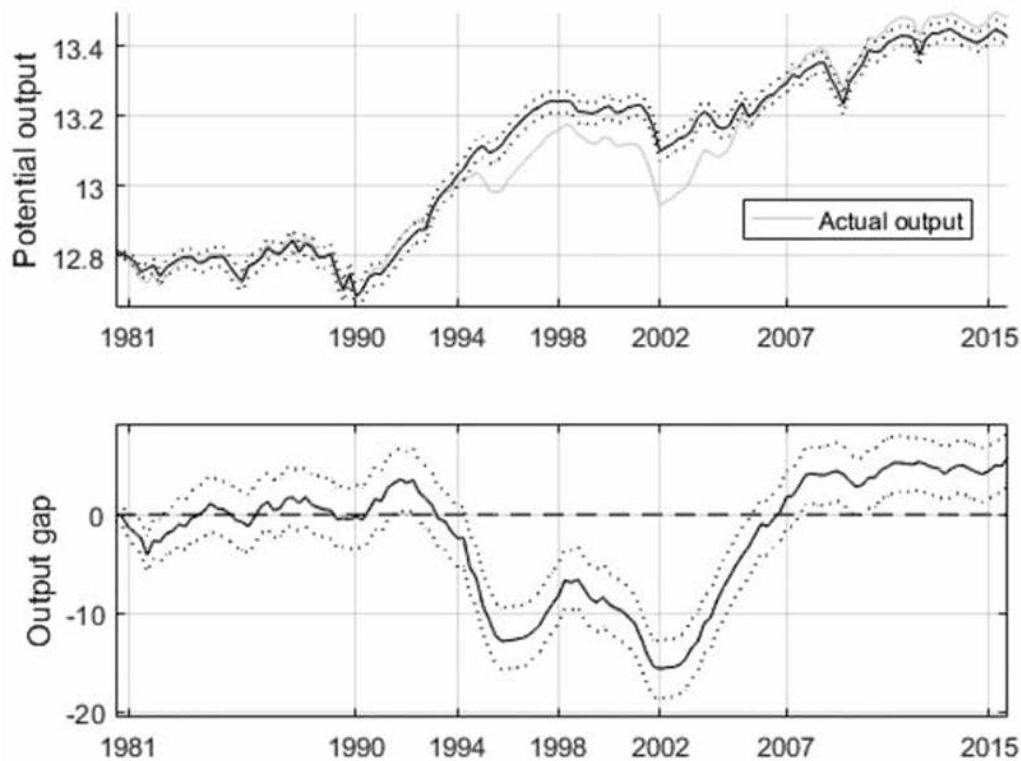


Figure 14. Potential output vs. Output gap in Argentina (1981-2015). Source: Campos, L. (2020). Potential output, output gap and high inflation in Argentina (2007-2015). *EconStor*.

From a comparative analysis of business cycles in Latin American economies, Argentina is shown to have a greater amplitude in business cycle fluctuations in comparison to other Latin American economies.³⁷ This instability is compounded by a long sequence of sovereign defaults and abrupt regime changes, which undermine the formation of stable expectations and prevent the consolidation of a credible nominal anchor. As of the mid-2010s, Argentina's macroeconomic environment remained structurally fragile, with

³⁶ Campos, L. (2020). *Potential output, output gap and high inflation in Argentina (2007–2015)*. EconStor.

³⁷ Izquierdo, A., Lama, R., Medina, J. P., Puig, J., Riera-Crichton, D., Vegh, C., & Vuletin, G. (2017). *Output gaps and policy stabilisation in Latin America*.

inflation inertia, fiscal imbalances, and external vulnerabilities deeply embedded in the economy.

A central structural constraint on Argentina's monetary policy has been fiscal dominance. IMF assessments document the recurrence of chronic primary deficits, reliance on monetary financing, and the absence of a credible medium-term fiscal anchor.³⁸ The institutional architecture of the "Banco Central de la República Argentina" (BCRA) further exacerbated these weaknesses: reforms in the early 2010s expanded the government's ability to access central bank resources and weakened de facto independence. Moreover, the credibility of official statistics was undermined significantly after 2007, as methodological changes and political interference led to the persistent divergence between the official and independent measurements of the CPI.³⁹ In contrast, those countries that successfully adopted inflation targeting, such as Chile, Colombia, and Peru, implemented legislative changes prior to the regime to strengthen the autonomy of their central banks and impose tight constraints on fiscal monetization. Argentina did not have such measures in place at the start of 2016.

Exchange rate dynamics also play a central role in Argentina's inflation process. The country's history of oscillating exchange rate regimes (exchange rate anchor, crawling bands, managed floats and episodes of multiple rates) and the prevalence of liability dollarization make even moderate nominal depreciations highly inflationary. Empirical evidence from price microdata shows that Argentina exhibits one of the highest exchange rate pass-through coefficients in the region, with even moderate depreciations rapidly translating into domestic prices.⁴⁰ This reflects widespread dollarization of savings and liabilities, and the use of the exchange rate as a salient reference price in both formal and informal markets. Recent analyses of digital dollarization, particularly the adoption of stablecoins, illustrate the public's limited confidence in the peso as a store of value and the structural fragility of the monetary system.⁴¹ Such sensitivity to exchange rate

³⁸ International Monetary Fund. (2016b). *Argentina: Selected Issues*. IMF Country Report No. 16/347.

³⁹ The Economist. (2014), *supra* note 35.

⁴⁰ Cavallo, A. (2013). Online and official price indexes: Measuring Argentina's inflation. *Journal of Monetary Economics*, 60(2), 152–165.

⁴¹ Garita, M. (2023). Stablecoins and inflation in Latin America: The case of Argentina. *Journal of Strategy and Management*, 17(1).

movements is incompatible with the smooth functioning of an IT regime, which requires a credible floating exchange rate and well-anchored expectations.

Argentina's inflation dynamics are further characterized by strong inertia and pervasive indexation. Micro-price evidence shows that price changes are common and synchronized, while wage contracts, regulated tariffs, and informal indexation mechanisms transmit past inflation into current price-setting behaviour.⁴² Studies on household inflation perceptions reveal that Argentine consumers systematically overestimate inflation, partly due to years of unreliable official statistics.⁴³ This bias reinforces backward-looking expectations and reduces the effectiveness of forward-looking monetary frameworks. The combination of indexation, adaptive expectations, and lack of credibility makes Argentina's Phillips Curve structurally unstable, an issue explored in Section 2.4.

In spite of these structural weaknesses, the Macri government sought to normalize the macroeconomic environment in Argentina by introducing Inflation Targeting in 2016. This was done in response to the lifting of capital controls, the unification of the exchange rate, and the resumption of publishing official inflation data. Inflation Targeting was meant to act as a transparent nominal anchor, to bring Argentina in line with best international practices, and to signal a break from the discretionary policy adopted in the prior decade. According to IMF assessments up to 2016, the reform was conceived as part of a broader stabilization strategy aimed at restoring policy credibility, attracting capital inflows, and achieving a gradual reduction in inflation.⁴⁴ However, the reform was implemented without the institutional, fiscal, and macroeconomic underpinnings that had accompanied successful IT reforms elsewhere, which eventually led to the loss of its credibility and the collapse of the regime in 2018.

⁴² Cavallo, A., & García Zavaleta, G. (2025). *Turning points in inflation: A structural breaks approach with micro data*. NBER Working Paper No. 34102.

⁴³ Cavallo, A., Cruces, G., & Perez-Truglia, R. (2016). *Learning from potentially-biased statistics: Household inflation perceptions and expectations in Argentina*. NBER Working Paper No. 22103. National Bureau of Economic Research.

⁴⁴ International Monetary Fund (2016), *supra* note 38.

2.2 Why Inflation Targeting Failed in Argentina (2016–2018)

The Latin American region has been described as an area where inflation targeting has been relatively successful, especially in Chile, Colombia, Brazil, Mexico, and Peru. The economies of these countries adopted IT only after laying the ground for a series of preconditions, including credible statistical systems, disciplined fiscal policies, autonomous monetary authorities, and exchange rate systems that enabled monetary policy to operate with a credible nominal anchor.⁴⁵ In these countries, inflation targeting was the final stage of a long process of institutional development, not the beginning of the stabilization path.

However, the Argentine case was very different. The country adopted inflation targeting in 2016 but did so in an environment characterized by persisting inflation, dominance of fiscal policy, and a significant decline in statistical credibility as a result of the intervention of the national statistical institute (INDEC) in 2007.⁴⁶ The structural underpinnings of the Argentine economy placed it at a very different position relative to other countries.

A central dimension of this divergence concerns the credibility of inflation statistics. The manipulation of official CPI data after 2007 created a persistent gap between official inflation and independent estimates. Cavallo's online price indices, based on high-frequency web-scraped data from Argentina's largest supermarkets, offer the most convincing evidence of this disparity.⁴⁷ While online and official indices show similar behaviour in Brazil, Chile, Colombia, and Venezuela, Argentina stands out as an outlier, with the online index increasing by more than twice between 2007 and 2011, compared to only one-third for the official index. Not only was this disparity large, but also its persistence was striking, highlighting the degree to which the credibility of official statistics had collapsed. The loss of statistical credibility also had direct implications for monetary policy, with unanchored expectations, wages based on inflations much higher than the official statistics, and difficulties for the central bank in finding a reliable measure of the price level on which to base its decisions. In fact, as shown in *Figure 15*, there are

⁴⁵ Taylor, J. B. (2019). Inflation targeting in high inflation emerging economies: Lessons about rules and instruments. *Journal of Applied Economics*, 22(1), 103–116.

⁴⁶ International Monetary Fund. (2016), *supra* note 38.

⁴⁷ Cavallo, A. (2013), *supra* note 40.

two cumulative price indices: the online index and the official INDEC index considering the example of supermarkets. While the official index rises gradually, the online index increases at more than twice the pace, producing a widening and persistent gap. This visual evidence illustrates the structural credibility problem facing Argentina's statistical system and the difficulty of anchoring expectations in such an environment.

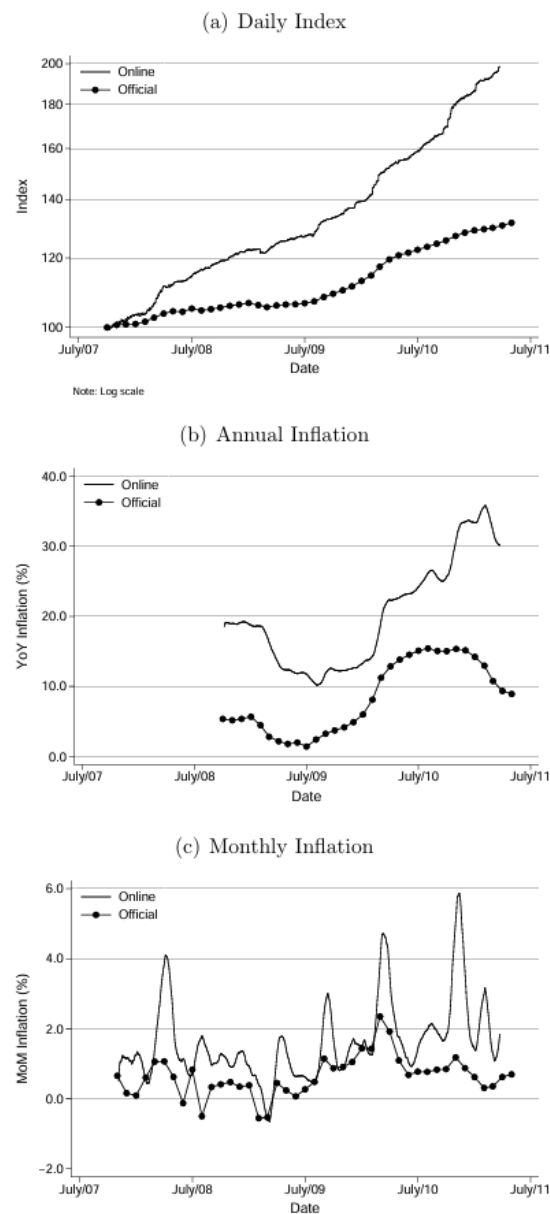
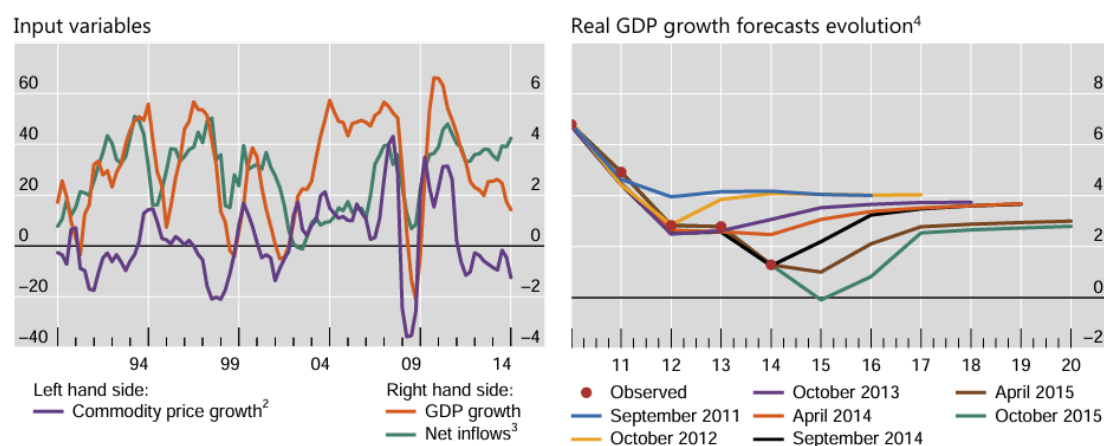


Figure 15. Online Supermarket Index in Argentina. Source: Cavallo, A. (2013). Online and Official Price Indexes: Measuring Argentina's Inflation. *Journal of Monetary Economics*, 60(2), 152–165.

Beyond measurement issues, Argentina also differed from its regional peers in terms of macroeconomic volatility. Comparative evidence from Latin American countries suggests that the output gap volatility in Argentina far exceeds those experienced by

countries such as Chile, Colombia, and Peru.⁴⁸ This output volatility provides valuable insights into the exposure of the Argentine economy to commodity price cycles, capital flow reversals, and policy uncertainty. The significant output volatility makes monetary policy more challenging to implement, as substantial output variability complicates the accurate calibration of policy interest rates and maintaining a disinflation path. This volatility is closely linked to Argentina's structural exposure to commodity price cycles and external capital flows, which have historically amplified domestic output fluctuations.

Figure 16 displays the relationship between commodity prices, economic growth, and capital flows into Latin America during 1994-2015, together with the changes in growth forecast estimates for each vintage year. The declining trend in forecast growth rates starting 2013 onwards shows the dependence of the Latin American economy on the commodity price cycle and the influence of external financial factors on growth. Argentina's case in the forecast panel exemplifies this pattern of repeated downward revisions, consistent with the structural fragility discussed above.



¹ Weighted averages based on GDP and PPP exchange rates for Brazil, Chile, Colombia, Mexico and Peru. ² Country specific commodity price index calculated using 3 digits exports weights for SITC Rev. 3. ³ As a share of GDP. ⁴ Including also Argentina.

Figure 16. GDP, commodity prices and net inflows in Latin America (in per cent). Source: Alberola, E., Gondo, R., Lombardi, M., & Urbina, D. (2016). *Output gaps and policy stabilisation in Latin America: The effect of commodity and capital flow cycles*. BIS Working Paper No. 568, Bank for International Settlements.

⁴⁸ Alberola, E., Gondo, R., Lombardi, M., & Urbina, D. (2016). *Output gaps and policy stabilisation in Latin America: The effect of commodity and capital flow cycles*. BIS Working Paper No. 568. Bank for International Settlements.

Another structural factor that sets Argentina apart is the behaviour of inflation expectations. Studies that have examined the perceptions of households in times of statistical manipulation have shown that Argentine consumers have consistently overestimated their inflation, even when compared to already high actual rates.⁴⁹ This phenomenon, which can be explained by years of unreliable statistics and constant adjustments in prices, created a backdrop in which both low and highly volatile inflationary expectations existed. This meant that the exchange rate pass-through to domestic prices remained one of the highest in the region. Countries with credible statistical institutions and stable inflation histories experienced lower pass through and more firmly anchored expectations, which facilitated the functioning of IT.

Figure 17 shows a plot of perceived inflation and actual inflation. It is evident that perceived inflation far exceeds actual inflation by a significant margin even during periods of stability in the actual inflation rate. This demonstrates the inherent credibility problem facing monetary policy and the difficulty of anchoring inflationary expectations in an environment where households systematically distrust the official statistics.

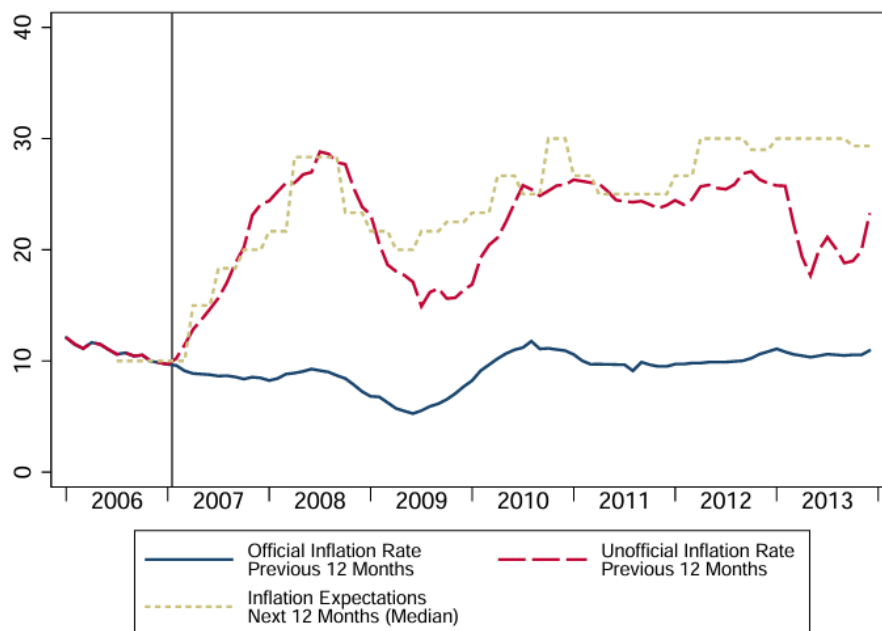


Figure 17. Official Statistics, Unofficial Statistics and Inflation Expectations, 2006-2013. Source: Cavallo, A., Cruces, G., & Perez-Truglia, R. (2016). *Learning from Potentially-Biased Statistics: Household Inflation Perceptions and Expectations in Argentina*. NBER Working Paper No. 22103, National Bureau of Economic Research.

⁴⁹ Cavallo, A., Cruces, G., & Perez-Truglia, R. (2016), *supra* note 43.

Taken together, these elements explain why Argentina represents an outlier within the Latin American IT experience. The country adopted the regime without the institutional robustness, fiscal discipline, macroeconomic stability and credibility foundations that characterized its regional peers. The combination of fiscal dominance, limited central bank independence, volatile output dynamics, elevated pass through and deeply unanchored expectations meant that the IT framework lacked the necessary conditions to operate effectively.

As several analyses have noted, Argentina attempted to use IT as a tool to reduce high inflation, whereas successful adopters had used it primarily to lock in already low inflation.⁵⁰ This divergence is essential for understanding the challenges faced by Argentina's monetary authorities after 2016 and provides the analytical bridge to the subsequent discussion of monetary policy reaction functions and inflation dynamics.

2.3 Argentina and the Taylor Rule: A Persistent Deviation

The Taylor Rule has emerged as a guiding framework to understand monetary policies in economies where institutional stability, expectation anchorages, and well-developed financial systems facilitate central banks to set interest rates mainly in response to inflation and output movements. In these economies, the Taylor Rule represents the essential features of systematic and countercyclical monetary policies. However, when the framework is applied to emerging economies like Argentina, its descriptive power declines significantly. In fact, Argentina has been experiencing a significant deviation in relation to the Taylor Rule not because of any divergence in monetary policies but because of the failure of underlying conditions to meet the requirements of the Taylor Rule.

A first source of divergence lies in the centrality of the exchange rate within Argentina's monetary transmission mechanism. In emerging markets, exchange rate fluctuations tend to pass through rapidly and strongly to domestic prices. Mohanty and Klau (2004) show that, across these economies, policy rates often respond more aggressively to exchange rate pressures than to inflation or output gaps, revealing a reaction function fundamentally

⁵⁰ Cachanosky, N. (2019). *Inflation targeting in Argentina: What went wrong?* American Institute for Economic Research.

different from the one implied by the Taylor Rule.⁵¹ Argentina exemplifies this pattern: the peso's chronic volatility, combined with widespread liability dollarisation, makes currency depreciation a direct threat to financial stability. As a result, the central bank frequently raises interest rates not to stabilise inflation, as the Taylor Rule would prescribe, but to defend the currency.

This behaviour is consistent with the classic “fear of floating” hypothesis formulated by Calvo and Reinhart (2000). Their work demonstrates that many emerging markets officially claim to float but in practice intervene heavily to prevent large exchange rate swings.⁵² In Argentina, the exchange rate acts not only as a relative price but also as a key anchor for expectations, a proxy for political credibility, and a transmission channel for balance sheet effects. In response to a quickening rate of depreciation, a central bank faces significant pressures to tighten monetary policy regardless of domestic cyclical conditions, resulting in procyclical interest rate behaviour that violates the Taylor Rule.

A related mechanism is the “fear of free falling”, described by Vegh and Vuletin (2012). They show that in many emerging markets, recessions coincide with capital outflows and sharp depreciations, forcing central banks to raise interest rates precisely when the Taylor Rule would call for easing.⁵³ Argentina fits this dynamic almost perfectly: downturns are typically accompanied by currency stress, reserve losses, and rising risk premia. In this environment, the central bank's priority becomes preventing a destabilising depreciation spiral, not smoothing the business cycle. This defensive stance structurally prevents the adoption of a countercyclical rule-based framework.

Empirical evidence specific to Argentina reinforces this interpretation. Neder and Farias (2019) estimate an extended Taylor Rule for the country and find that the policy rate reacts significantly to exchange rate movements and fiscal imbalances, while the response to inflation and output is weak or inconsistent.⁵⁴ Their results suggest that Argentina's monetary policy cannot be described by a standard rule: the exchange rate and fiscal dynamics systematically dominate the central bank's reaction function. In other words,

⁵¹ Mohanty, M. S., & Klau, M. (2004). *Monetary policy rules in emerging market economies: Issues and evidence*. BIS Working Paper No. 149.

⁵² Calvo, G. A., & Reinhart, C. M. (2000). *Fear of floating*. NBER Working Paper No. 7993.

⁵³ Vegh, C. A., & Vuletin, G. (2012). *Overcoming the fear of free falling: Monetary policy graduation in emerging markets*. NBER Working Paper No. 18175.

⁵⁴ Neder, Á. E., & Farias, J. M. (2019). *Rule, what rule? Argentina and its monetary policy rule*. ResearchGate.

Argentina does not “ignore” the Taylor Rule, but rather it operates in an environment where the assumptions underlying the rule (namely, credible institutions, anchored expectations, and a stable nominal anchor) are absent.

Furthermore, the broader Latin American experience serves to reinforce the exceptionalism of the Argentine case. Corbo and Schmidt-Hebbel (2001) show the successful implementation of inflation targeting regimes coupled with better institutions and more flexible exchange rate regimes by a number of countries in the Latin American region.⁵⁵ These countries gradually converged toward rule-like behaviour. Argentina, however, has not followed this trajectory: repeated episodes of fiscal dominance, inflationary inertia, and currency crises have prevented the establishment of a credible nominal anchor. Without credibility, the Taylor Rule becomes not only impractical but potentially destabilising.

Collectively, these factors provide an explanation for the persistent deviation of the Argentine economy from the Taylor Rule. The high exchange rate pass-through, liability dollarisation, external shocks, and lack of institutional credibility impose strong pressures on the local monetary authority to focus on currency stabilisation, rather than pursuing local objectives. The Argentine economy’s deviation from the Taylor Rule is, in fact, no anomaly, but rather the natural consequence of the country’s structural conditions.

2.4 The Phillips Curve in Argentina: Instability and Structural Non-Linearity

The empirical pattern of the Phillips Curve in Argentina reveals the persistence of instability and non-linearity in the economy. In contrast, other countries in Latin America have successfully adopted inflation targeting and present a stable relationship between inflation and economic slack. However, the case of Argentina is different. The country has been characterized by inertia, exchange rate shocks, and credibility problems that undermine the pass-through effects of domestic demand on prices. Accordingly, the Phillips Curve in Argentina is not only flat but also highly sensitive to regime shifts and structural non-linearities.

⁵⁵ Corbo, V., & Schmidt-Hebbel, K. (2001). *Inflation targeting in Latin America*. Banco Central de Chile.

A first source of instability arises from the country's chronic inflationary environment. D'Amato and Garegnani (2009) document that, both during the 1990s and in the post-Convertibility years, Argentine price dynamics were dominated by inertia: past inflation weighed more heavily on current price-setting than expectations about the future.⁵⁶ This predominance of inertia implies that firms adjust prices based on past inflation rather than on expected future conditions, reducing the responsiveness of inflation to the output gap. The authors also identify a clear structural break in 2002, coinciding with the collapse of the currency board, after which inflation persistence increased, and the influence of the output gap weakened further. This break marks the beginning of a regime in which the Phillips Curve becomes structurally flatter and more difficult to estimate.

The weakness of the Phillips Curve is further confirmed by the IMF's 2016 Article IV Staff Report, which highlights the predominance of backward-looking wage formation and the high pass-through from the exchange rate to domestic prices.⁵⁷ In this context, inflation responds more to nominal depreciations than to domestic slack, undermining the core mechanism through which inflation targeting is expected to operate. The IMF's small macro model for Argentina shows that even substantial increases in real interest rates generate only modest disinflationary effects unless accompanied by a contraction in activity and an appreciation of the real exchange rate.⁵⁸ This implies a high sacrifice ratio and a limited role for the output gap in driving inflation.

The most recent evidence reinforces this diagnosis. Bertholet, Montes Rojas and Toledo (2025) estimate a traditional Phillips Curve for 2003–2022, pointing out that the negative relationship between unemployment and inflation emerges only when controlling for the nominal exchange rate.⁵⁹ In the absence of such control, the effectiveness of the Phillips curve disappears. This relationship, even if properly specified, will be one-directional and asymmetric. Increases in unemployment will lower inflation, while increases in inflation will have little effect on lowering unemployment rates in the long run. This asymmetry is

⁵⁶ D'Amato, L., & Garegnani, M. L. (2009). *Studying the short-run dynamics of inflation: Estimating a hybrid New-Keynesian Phillips Curve for Argentina (1993–2007)*. BCRA Working Paper Series, No. 40. Central Bank of Argentina.

⁵⁷ International Monetary Fund. (2016a). *Argentina: 2016 Article IV Consultation—Staff Report*.

⁵⁸ Canales-Kriljenko, J. I. (2016). Disinflation under inflation targeting: A small macro model for Argentina. In *Argentina: Selected Issues, IMF Country Report No. 16/347* (pp. 87–107). International Monetary Fund.

⁵⁹ Bertholet, N., Montes Rojas, G., & Toledo, F. (2025). *Estimación de curva de Phillips y cociente de sacrificio en Argentina (2003–2022)*. ResearchGate.

a hallmark of structural non-linearity and suggests that the Phillips Curve operates only under specific conditions, namely, when recessions are deep enough to offset the inflationary impact of exchange rate movements.

A further layer of non-linearity emerges from threshold effects. Although the literature on non-linear Phillips Curves is largely based on advanced economies, its insights are relevant for Argentina. The threshold regression approach developed by Hansen (2000), applied in recent work on non-linearities in the United States, shows that the slope of the Phillips Curve may change across regimes, becoming flatter at high levels of slack.⁶⁰ While not specific to Argentina, this evidence suggests a conceptual framework by which to understand the Argentine experience. The experience of repeated episodes of high rates of unemployment and significant output gaps may have locked the Argentine economy into the "flat" part of the Phillips Curve, where inflation appears insensitive to local conditions. Results of the research by Bertholet, Montes Rojas, and Toledo (2025) confirm that changing the Phillips Curve along with the exchange rate shocks is very important. Even though the authors agree that the slope of the Phillips Curve is very shallow, the results still show the significant role of the exchange rate shocks in the adjustment of the Phillips Curve.

The ineffectiveness of the inflation targeting policy in the period 2016-2018 also indicates the structural weakness of the Phillips curve. As shown by Cachanosky and Ferrelli Mazza (2021), the regime collapsed because inflation expectations never anchored, the central bank lacked credibility, and exchange rate shocks dominated the inflation process.⁶¹ In such a setting, the Phillips Curve cannot be a dependable tool for monetary policy because the relationship between interest rates, activity, and inflation gets continuously broken.

Put together, these findings indicate a Phillips Curve that not only has time-varying instability but also is structurally non-linear in nature. Its slope changes from one regime to another, its importance is conditional upon the incorporation of key external variables, and its reaction is influenced by deep institutional and macroeconomic features (namely, chronic inflation, fiscal dominance, exchange rate volatility, and trust deficits). These

⁶⁰ Hansen, B. (2000). Sample splitting and threshold estimation. *Econometrica*, 68(3), 575–603.

⁶¹ Cachanosky, N., & Ferrelli Mazza, F. (2021). *Why did inflation targeting fail in Argentina?* Quarterly Review of Economics and Finance, 80, 102–116.

traits are greatly weakening the power of inflation targeting and are making disinflation strategies more complex to design, which are the ones that demand significant contractions in economic activity in order to achieve modest reductions in inflation.

Chapter 3: Empirical Outlook on Argentina's Future Inflation Dynamics

3.1 Data and Methodology

The empirical analysis presented in this chapter covers the period from 2000Q1 to 2026Q1 and estimates two complementary models for Argentina: a Taylor Rule, which describes how the policy interest rate has been set by the central bank, and an Augmented Phillips Curve, which describes how inflation has evolved. The chosen sample includes the major episodes of the country's recent monetary experience: the recovery from the breakdown of the Convertibility regime, the long phase of heterodox monetary policy, the formal introduction of inflation targeting in 2016, and the subsequent macroeconomic developments up to the most recent observations. Quarterly frequency is used throughout, in line with the standard practice in the empirical monetary literature on emerging economies.

The inflation series is built from the monthly Consumer Price Index released by the Banco Central de la República Argentina (BCRA).⁶² Each quarterly value is obtained by averaging the three corresponding monthly observations, producing a series of quarterly inflation rates expressed in percentage terms.

The output gap comes from the OECD Economic Outlook database,⁶³ which publishes the series at annual frequency. For the purposes of this analysis, the gap is treated as constant within each calendar year, with the same annual value carried over to all four quarters.

The nominal short-term policy interest rate is sourced from the OECD Economic Outlook database as well,⁶⁴ where it is reported at quarterly frequency for Argentina.

A binary indicator, denoted IT_t , marks the period in which Argentina operated under a formal inflation targeting regime. The variable equals one from 2016Q1 onwards, when

⁶²Banco Central de la República Argentina (BCRA). Series estadísticas: Índice de Precios al Consumidor.

⁶³OECD. Economic Outlook database: Output gap as a percentage of potential GDP — Argentina.

⁶⁴OECD. Economic Outlook database: Short-term interest rates — Argentina.

the BCRA announced the adoption of the new framework, and zero otherwise. The dummy variable is exploited to test whether the regime switch in 2016 produced a measurable shift in inflation dynamics and in the interest-rate-setting behaviour of the central bank.

In both models, the real neutral interest rate together with the long-run inflation anchor are absorbed into the constant term of the estimated equation, where they are jointly identified with all other time-invariant components. This is standard practice in the empirical Taylor Rule literature.⁶⁵

Stationarity of each series is verified through the Augmented Dickey-Fuller (ADF) test prior to estimation. The corresponding results are presented in Section 3.3 and discussed in light of the chosen estimation strategy.

Two complementary methodological approaches are employed in this chapter. The first, presented in Section 3.1.1, follows an Autoregressive Distributed Lag (ARDL) framework for the Phillips Curve and applies Newey-West HAC standard errors to the Taylor Rule. The second, presented in Section 3.1.2, adopts an Ordinary Least Squares estimator for the Taylor Rule and a hybrid New Keynesian formulation for the Phillips Curve. Using two approaches in parallel makes it possible to verify that the qualitative conclusions of the analysis do not depend on a single methodological choice.

The empirical strategy adopted in the main analysis follows a parsimonious approach. The Taylor Rule is estimated by Ordinary Least Squares, with the methodological appropriateness of this estimator established by Carvalho, Nechio and Tristão (2021),⁶⁶ whose analytical and Monte Carlo results show that the endogeneity bias affecting single-equation OLS estimates is proportional to the share of regressor variance attributable to monetary policy shocks, and that this share is empirically negligible. The Augmented Phillips Curve is estimated in the hybrid New Keynesian form following Galí and Gertler (1999)⁶⁷ and consistent with the empirical strategy applied to Argentina by D'Amato and

⁶⁵Clarida, R., Galí, J., & Gertler, M. (2000). Monetary policy rules and macroeconomic stability: Evidence and some theory. *Quarterly Journal of Economics*, 115(1), 147-180.

⁶⁶Carvalho, C., Nechio, F., & Tristão, T. (2021). Taylor rule estimation by OLS. *Journal of Monetary Economics*, 124, 140-154.

⁶⁷Galí, J., & Gertler, M. (1999). Inflation dynamics: A structural econometric analysis. *Journal of Monetary Economics*, 44(2), 195-222.

Garegnani (2009).⁶⁸ In this formulation, current inflation depends on its previous value, which captures the backward-looking and inertial component of price formation, and on a measure of real activity. In the baseline specification just the first lagged value of the inflation rate is included, preventing from multicollinearity.

Robustness checks employing alternative econometric specifications, namely an Autoregressive Distributed Lag (ARDL) framework with Newey-West HAC standard errors for the Taylor Rule and AIC-selected ARDL specifications for the Phillips Curve, are presented in the Appendix. The convergence of qualitative conclusions across the main analysis and the robustness checks strengthens the reliability of the empirical findings.

3.2 Empirical Models

3.2.1. The Argentine Taylor Rule

The Taylor Rule is estimated in two successive specifications. The baseline captures the contemporaneous response of the central bank to inflation and to real activity. The extended specification introduces interaction terms between the inflation targeting dummy and the main explanatory variables, in order to identify whether the 2016 regime change altered the central bank's reaction function.

The baseline specification takes the form:

$$i_t = \mu + \varphi_y \cdot outputgap_t + \varphi_\pi \cdot \pi_t + \varepsilon_t$$

where i_t is the nominal short-term policy rate; μ absorbs the real neutral interest rate together with all other time-invariant components; φ_y measures the response of the BCRA to contemporaneous real activity; and φ_π measures the response to current inflation. A stabilising monetary policy in the standard Taylor framework requires $\varphi_\pi > 1$ (the Taylor Principle) and $\varphi_y > 0$ (counter-cyclical response to the output gap).

If one lag of the output gap is added in order to test whether the BCRA reacts to real activity with a delay, we obtain the following:

⁶⁸ D'Amato, L., & Garegnani, M. L. (2009), *supra* note 56.

$$i_t = \mu + \varphi_y \cdot outputgap_t + \rho_y \cdot outputgap_{\{t-1\}} + \varphi_\pi \cdot \pi_t + \varepsilon_t$$

The extended specification is the most informative for the central question of this thesis. It introduces two interaction terms between the inflation targeting dummy IT_t and the main explanatory variables, namely the contemporaneous output gap and contemporaneous inflation:

$$i_t = \mu + \varphi_y \cdot outputgap_t + \rho_y \cdot outputgap_{\{t-1\}} + \varphi_\pi \cdot \pi_t + \delta_y (IT_t \cdot outputgap_t) + \delta_\pi (IT_t \cdot \pi_t) + \varepsilon_t$$

In this specification, φ_y measures the response of the BCRA to the output gap during the pre-2016 period, while $\varphi_y + \delta_y$ measures the corresponding response in the post-2016 period. Similarly, φ_π identifies the response to inflation before the regime change, and $\varphi_\pi + \delta_\pi$ identifies it afterwards. A statistically significant δ_y indicates that the 2016 regime change altered the way in which the central bank reacts to the business cycle, while a statistically significant δ_π would indicate a change in its response to inflation.

Three hypotheses can be tested using these equations. First, whether the BCRA's response to inflation is consistent with the Taylor Principle ($\varphi_\pi > 1$). Second, whether the central bank's response to the output gap is counter-cyclical, as theory would prescribe ($\varphi_y > 0$). Third, whether the 2016 adoption of inflation targeting produced a structural change in the BCRA's reaction function, as captured by the interaction coefficients δ_y and δ_π . The results are presented in Section 3.3.1.

3.2.2 The Argentine Augmented Phillips Curve

The Augmented Phillips Curve is estimated in the hybrid New Keynesian form, in which current inflation depends on its first lag and on the output gap. This is the canonical specification in the empirical literature on inflation dynamics in emerging economies, and it provides a parsimonious framework able to capture both the backward-looking inertial component of price formation and the demand-side pressure exerted by the output gap.⁶⁹

⁶⁹The hybrid New Keynesian Phillips Curve is a standard specification in the empirical literature on inflation dynamics. For its theoretical foundations, see Galí and Gertler (1999); for its application to Argentina, see D'Amato and Garegnani (2009); for a comparative application to Latin American economies, see Caporale et al. (2018).

The baseline equation is:

$$\pi_t = \alpha + \theta \cdot \pi_{\{t-1\}} + \beta \cdot outputgap_t + \varepsilon_t$$

where π_t is quarterly inflation, $\pi_{\{t-1\}}$ is its first lag, $outputgap_t$ is the yearly output gap, α absorbs the long-run inflation anchor and all other time-invariant components, and ε_t is the error term. The parameter θ captures the degree of inflation inertia, while β captures the sensitivity of inflation to demand-side pressure.

The extended specification adds two interaction terms between the inflation targeting dummy IT_t and the main regressors:

$$\begin{aligned} \pi_t = & \alpha + \theta \cdot \pi_{\{t-1\}} + \beta \cdot outputgap_t + \gamma_1 (IT_t \cdot \pi_{\{t-1\}}) \\ & + \gamma_2 (IT_t \cdot outputgap_t) + \varepsilon_t \end{aligned}$$

In the pre-2016 period ($IT_t = 0$), the inertia coefficient is θ and the output gap coefficient is β . In the post-2016 period ($IT_t = 1$), they become $\theta + \gamma_1$ and $\beta + \gamma_2$. A statistically significant γ_1 indicates that the 2016 regime change altered the degree of inflation inertia, while a significant γ_2 indicates a change in the sensitivity of inflation to the output gap.

Three hypotheses are tested through these equations: whether inflation in Argentina exhibits significant inertia (θ), whether the output gap drives inflation (β), and whether the 2016 regime change produced a structural shift (γ_1 and γ_2). Alternative specifications with multiple lags of inflation, estimated within an ARDL framework with AIC-selected lag lengths, are reported as robustness checks in the Appendix. The main results are reported in Section 3.3.2.

3.3 Results

3.3.1 The Argentine Taylor Rule

The Augmented Dickey-Fuller (ADF) test was first performed on all variables used in the model. The three series are borderline non-stationary at the 5% confidence level and stationarity at the 10%: the interest rate (p-value = 0.052), inflation (p-value = 0.053) and the output gap (p-value = 0.090). Given the stationarity at the 10% confidence level, the variables are retained in levels for the estimation that follows.

The two specifications are reported in *Table 1*. The baseline returns a coefficient on inflation of 7.4654, significant at the 1% level, and a coefficient on the output gap equal to -0.7694, also significant at the 1% level. The constant is positive and significant.

Two features of these results must be highlighted. First, the coefficient on inflation lies well above unity in both specifications, which would superficially suggest compliance with the Taylor Principle. The magnitude is however implausibly large for a genuine policy response: a value of around 7.5 would imply that a one-percentage-point rise in inflation is on average matched by a more than seven-percentage-point rise in the nominal policy rate. This figure is much closer to a mechanical correlation between elevated nominal rates and elevated inflation than to a deliberate anti-inflationary stance. During episodes of acute instability, nominal rates were raised to defend the currency, attract capital inflows and finance the public sector, rather than to decrease inflation. This pattern is consistent with the fiscal dominance documented in Chapter 2 and with the findings of Cachanosky and Ferrelli Mazza (2021).⁷⁰

Second, and more striking, the coefficient on the output gap is negative and statistically significant. This finding goes against the standard Taylor prescription, under which a counter-cyclical central bank should cut nominal rates when output falls below potential, not raise them. In the Argentine experience, however, episodes of output below potential (including the recessions of 2001–2002, 2009 and 2014) coincided with disorderly devaluations, capital flight and emergency rate hikes designed to defend the peso. Conversely, periods of output above potential coincided with fiscal expansion, commodity booms and capital inflow surges, which exerted downward rather than upward pressure on nominal rates. The negative sign on the output gap thus reflects the inversion of the standard interest rate–cycle relationship under conditions of severe macroeconomic instability. Nevertheless, a weak magnitude of the output gap coefficient can signal a stronger concern (and resulting reaction as well) of the central bank for price stability rather than growth.

The extended specification (2) sheds more light on the evolution of monetary policies over time. Controlling for the interaction terms between the inflation targeting dummy

⁷⁰ Cachanosky, N., & Ferrelli Mazza, F. J. (2021). Why did inflation targeting fail in Argentina? *Quarterly Review of Economics and Finance*, 80, 102–116.

and the main explanatory variables, this specification allows the BCRA's reaction function to differ structurally between the pre-2016 and post-2016 periods. The results yield a clear and economically meaningful pattern. The coefficient on the contemporaneous output gap in the pre-IT period is still negative and statistically significant ($\varphi_y = -0.8223$, p-value < 0.01). Nonetheless, the interaction term with the inflation targeting dummy is positive, large and significant at the 1% level ($\delta_y = 1.0274$). In the post-2016 period, the implied response of the policy rate to the output gap is therefore $\varphi_y + \delta_y = -0.8223 + 1.0274 \approx 0.21$, which moves the coefficient from a clearly negative value in the pre-IT period to a slightly positive value in the post-IT period. As a matter of fact, after the adoption of inflation targeting, the negative correlation between the output gap and the policy rate that characterised the previous era vanishes, and the BCRA's response to real activity moves towards the sign that standard monetary theory would prescribe.

By contrast, the interaction between the inflation targeting dummy and contemporaneous inflation is not statistically significant ($\delta_\pi = -1.3838$, p-value ≈ 0.20). The coefficient on inflation itself remains strongly positive and significant in the post-IT period ($\varphi_\pi = 8.7459$, p-value < 0.01). Two implications follow. First, there is no evidence that the 2016 regime change altered the BCRA's response to inflation in a way that can be distinguished from statistical noise. Second, the persistent magnitude of φ_π confirms that the strong positive correlation between nominal rates and inflation captured by the regression is a structural feature of Argentine monetary policy rather than a feature of either regime in isolation, and reflects the mechanical link between high inflation and high nominal rates discussed above. On the other hand, it could be argued that Argentine monetary institutions used to behave according to the Taylor rule, pursuing some target of inflation, even before 2016, without any attempt to anchor agents' inflation expectations and providing lower degree of guidance to the public.

Taken together, the two specifications support a consistent reading of the BCRA's behaviour. Before 2016, the central bank did not clearly operate as a Taylor-style monetary authority along either dimension of the standard reaction function: its response to inflation was numerically high but economically uninformative, and its response to the output gap was negative, opposite to what theory would prescribe. The adoption of

inflation targeting in 2016 is associated with a meaningful change along one dimension only: the response to the output gap, but not with a change in the response to inflation. This pattern is consistent with the structural diagnosis of Chapter 2: the formal adoption of inflation targeting partially normalised the BCRA's response to the business cycle, but it did not transform the underlying monetary policy process, which remained dominated by exchange rate considerations, fiscal financing requirements and capital flow dynamics. A robustness check employing an additional specification with lagged output gap is reported in the Appendix and confirms the qualitative conclusions of the main analysis.

Table 1. Taylor Rule estimation with Newey-West HAC standard errors (Argentina 2000Q1–2026Q1)

VARIABLES	1	2
Output gap	-0.7694***	-0.8223***
	(0.1596)	(0.2682)
L1.Output gap		-0.3247
		(0.2379)
Inflation rate	7.4654***	8.7459***
	(0.3646)	(1.1806)
Output gap $\times$ post_IT		1.0274***
		(0.3228)
Inflation $\times$ post_IT		-1.3838
		(1.0873)
Constant	11.6420***	11.7839***
	(1.2895)	(1.4441)
Observations	105	104
R-squared	0.8341	0.8558

Notes: Standard errors are reported in parentheses.

*** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$.

Sample: 2000Q1 – 2026Q1.

Source: BCRA, OECD.

3.3.2 The Argentine Augmented Phillips Curve

The same ADF test results discussed in Section 3.3.1 apply equally to the inflation and output gap series used here. The variables are retained in levels for the estimation that follows, in line with similar studies on inflation dynamics in emerging economies.

The results for the two specifications are reported in *Table 2*. The baseline returns a coefficient on lagged inflation of 0.8542, statistically significant at the 1% level, and a coefficient on the output gap of -0.0072, not statistically distinguishable from zero. The high coefficient on lagged inflation indicates that, over the full sample, inflation in Argentina is strongly persistent: roughly 85% of last period's inflation rate is mechanically transmitted to the current period. The fact that the output gap does not enter significantly suggests that the standard demand-side channel of the Phillips Curve plays a marginal role in the Argentine context, where inflation dynamics are dominated by inertia and by other forces (including exchange rate pass-through, monetary financing of the deficit, indexation mechanisms), which are not directly captured by a measure of domestic real activity. This finding is consistent with the backward-looking nature of price formation in Argentina documented by D'Amato and Garegnani (2009)⁷¹ and discussed in Chapter 2, where inflation inertia was identified as one of the structural barriers to the effectiveness of inflation targeting.

The extended specification with interaction terms provides further evidence on how the inflation process changed around the 2016 regime shift. The coefficient on lagged inflation, which now measures the degree of inertia during the pre-IT period, drops to $\theta = 0.4277$ and remains statistically significant. The interaction term between the inflation targeting dummy and lagged inflation is positive and statistically significant ($\gamma_1 = 0.4090$, p-value < 0.05). The implied degree of inflation inertia in the post-IT period is therefore $\theta + \gamma_1 = 0.4277 + 0.4090 \approx 0.8367$, almost double the level prevailing before the regime change. The output gap coefficient remains close to zero and statistically insignificant in both subperiods, and the corresponding interaction term γ_2 is also small and insignificant.

This result is one of the most important findings of the empirical analysis. It indicates that the introduction of inflation targeting in Argentina did not break the inertial component

⁷¹ D'Amato, L., & Garegnani, M. L. (2009), *supra* note 56.

of the inflation process. On the contrary, the degree of persistence rose substantially after 2016. Although a regression-based interaction term cannot, on its own, prove a causal mechanism, the post-2016 period coincides with several developments likely to have entrenched backward-looking price-setting behaviour: the rapid de-anchoring of inflation expectations following the failure of the initial targets, the resurgence of widespread indexation in wage and contract negotiations, and the hyperinflationary episode of 2022–2024 that followed the abandonment of the regime. The combination of these factors is consistent with the structural argument developed in Chapter 2, namely that the formal adoption of inflation targeting in Argentina was undertaken in the absence of the institutional and macroeconomic preconditions required for the framework to anchor expectations effectively.

The lack of significance of the output gap coefficients in both subperiods is itself informative. In the canonical Phillips Curve, the output gap is the central transmission channel through which monetary policy can affect inflation by influencing aggregate demand. The fact that this channel is empirically weak in Argentina across the full sample, and in both the pre-IT and post-IT subperiods, indicates that the standard mechanism through which inflation targeting is supposed to work is structurally muted in this economy. Inflation in Argentina is driven by forces other than the conventional demand-side pressure that the BCRA could influence through its policy rate. This finding supports the broader conclusion that the inflation targeting framework, as adopted in 2016, was technically incapable of producing the disinflation it had promised, because the very channel through which the regime is meant to operate was not present in the underlying inflation process.

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2016, was technically incapable of producing the disinflation it had promised, because the very channel through which the regime is meant to operate was not present in the underlying inflation process. Alternative specifications with multiple lags of inflation, estimated within an ARDL framework, are reported as robustness checks in the Appendix and confirm the qualitative conclusions of the main analysis.

Table 2. Augmented Phillips Curve estimation, ARDL with AIC-selected lags (Argentina 2000Q1–2026Q1)

VARIABLES	1	2
L1.Inflation rate	0.8542***	0.4277**
	(0.0522)	(0.1752)
Output gap	-0.0072	-0.0315
	(0.0228)	(0.0269)
IT × L1.Inflation		0.4090**
		(0.1621)
IT × Output gap		0.0550
		(0.0468)
Constant	0.3541*	0.6363***
	(0.1849)	(0.2081)
Observations	104	104
R-squared	0.7405	0.7585

Notes: Standard errors are reported in parentheses.

*** p<0.01, ** p<0.05, * p<0.1.

Hybrid New Keynesian Phillips Curve specification with one lag of inflation, following Galí and Gertler (1999).

Sample: 2000Q1 – 2026Q1.

Source: BCRA, OECD.

Conclusions

This work seeks to examine whether the inflation targeting regime introduced by Argentina in 2016 functioned as an effective monetary policy framework, and to identify the structural conditions under which inflation targeting can succeed in emerging economies. The research question was addressed in two complementary ways: through a comparative analysis of monetary policy across Latin America, which identified the structural conditions under which inflation targeting has operated effectively in the region, and through an empirical investigation of Argentine monetary policy and inflation dynamics over the 2000Q1–2026Q1 period.

The comparative analysis undertaken in the first two chapters revealed conditions related to institutions and macroeconomic stability that marked the difference between the cases of the successful Latin American inflation targeters (Brazil, Chile, Colombia, Mexico and Peru) and the case of Argentina. The first was fiscal discipline: the regional inflation targeters had made a full transition away from monetary financing of public deficits before adopting the framework, whereas in Argentina the structural condition remained the dependence of monetary policy on fiscal policy. Second, the central bank independence: while in the regional peers the latter became consolidated already during the 1990s, in Argentina the process went in reverse and saw frequent interventions by the government, along with the 2007 intervention of the INDEC. Third, the credibility of inflation measurement: while the former were endowed with reliable statistical systems, Argentina entered the regime with a measurement gap so great that the difference between online prices and the official index, documented in Cavallo (2013), persisted over several years. The fourth was the structural environment in which the framework was meant to operate: unlike their regional peers, Argentina tried to use inflation targeting as a disinflation instrument in an inherently high-inflation environment. As several authors have noted, this is precisely the configuration under which the framework was not designed to operate.

The third chapter assessed whether these structural diagnoses manifest themselves in terms of observable characteristics of the monetary policy process in Argentina and of the corresponding inflation dynamic process. The empirical analysis was carried out using a parsimonious hybrid New Keynesian specification estimated by OLS, with interaction

terms between the inflation targeting dummy and the main explanatory variables in order to capture the structural change associated with the 2016 reform. Alternative econometric specifications, including ARDL frameworks with AIC-selected lag lengths and Newey-West HAC standard errors, were employed as robustness checks and are reported in the Appendix. The qualitative conclusions of the analysis are confirmed across all specifications.

Two main findings emerge from the empirical analysis. The first concerns the reaction function of the BCRA. The estimation identifies a large and statistically significant positive coefficient on inflation, of a magnitude that is far too high to represent a genuine Taylor-type response: it captures instead the mechanical link between elevated nominal rates and elevated inflation during episodes of macroeconomic instability. The estimation also identifies a negative and significant coefficient on the output gap in the pre-2016 period, contrary to what standard monetary theory would prescribe. This finding mirrors the structural argument developed in the second chapter: nominal rates in Argentina were historically set to defend the exchange rate, attract capital inflows and finance public-sector borrowing, rather than to stabilise the business cycle. The interaction-based specification adds a further insight: the response of the policy rate to the output gap moves from clearly negative in the pre-IT period to slightly positive in the post-IT period, pointing to a partial normalisation of the BCRA's response to real activity. The response to inflation, by contrast, shows no statistically detectable change across the two regimes, indicating that the formal adoption of inflation targeting did not transform the underlying logic of monetary policy along this dimension.

The second finding concerns inflation dynamics themselves. The empirical analysis shows that inflation in Argentina is highly persistent across the full sample, with an inertia coefficient close to unity. The analysis also reveals that this persistence did not decline after 2016 but, on the contrary, increased substantially in the post-IT period, almost doubling relative to its pre-IT level. The output gap, the canonical demand-side channel through which monetary policy is meant to affect inflation under an inflation targeting regime, plays no statistically significant role in either subperiod. This is the empirical counterpart of the structural diagnosis developed in the second chapter: the very mechanism through which inflation targeting is supposed to anchor expectations and decrease inflation was structurally muted in the Argentine case.

Taken together, the structural analysis and the empirical evidence converge on a coherent answer to the research question that opened this thesis. The inflation targeting framework adopted by Argentina in 2016 did not deliver the disinflation it had promised, and the reasons for this outcome go beyond design or implementation errors. The failure reflects the absence of the structural, institutional and macroeconomic preconditions on which the framework depends. Fiscal dominance subordinated monetary policy to the financing needs of the public sector; the high pass-through from the exchange rate to domestic prices made inflation respond to currency dynamics rather than to the policy rate; the strong backward-looking inertia in price-setting made inflation insensitive to the official target announced by the central bank; and the loss of statistical and institutional credibility prevented the regime from anchoring expectations. Within this setting, the empirical normalisation of the BCRA's response to the output gap, identified in the third chapter, represents a partial step toward Taylor-style behaviour but is insufficient to compensate for the absence of the broader preconditions that the framework requires.

The findings of this thesis carry several implications. From a theoretical standpoint, the Argentine case illustrates that inflation targeting is not a self-contained monetary technology that can be transplanted into any environment with the expectation of producing the same results observed elsewhere. The framework is an institutional architecture that presupposes a series of conditions, and where those conditions are absent, the formal adoption of the regime cannot generate the outcomes it normally delivers. The contrast with the five regional peers makes this dependence on preconditions particularly clear: the same framework that anchored expectations and reduced inflation in Brazil, Chile, Colombia, Mexico and Peru produced none of these results in Argentina, despite the technical features of the regime being broadly comparable across the cases. The robustness of these conclusions across different econometric specifications strengthens their empirical foundation.

From a policy standpoint, the analysis suggests that the future trajectory of Argentine inflation will depend less on the formal monetary framework that the country chooses to adopt and more on whether the underlying preconditions can be built. Restoring fiscal discipline, rebuilding the credibility of the central bank, repairing the statistical infrastructure of the country and reducing the structural pass-through from the exchange

rate to domestic prices are prerequisites for any monetary regime to anchor expectations effectively.

The empirical analysis presented in this thesis is subject to several limitations that should be noted. First, the BCRA inflation series used over the full sample includes the 2007–2015 subperiod, during which official statistics systematically understated the actual inflation rate. This introduces a measurement error that may affect the precision of the estimates, although the qualitative conclusions are unlikely to change. Future research could refine the analysis by constructing a spliced inflation series that uses alternative price indices for the period of statistical distortion. Second, the output gap series is available only at annual frequency and is treated as constant within each calendar year, which limits the precision of the contemporaneous estimates. Third, the hyperinflationary episode of 2022–2024 acts as a strong source of variation in the post-IT subperiod and may exert a disproportionate influence on the estimated interaction coefficients; future work could refine the analysis by treating this episode as a separate regime rather than as part of the inflation targeting period. Fourth, the Phillips Curve specification adopted in this thesis does not include the exchange rate as an explicit explanatory variable. Given the high pass-through documented in Chapter 2, future research could extend the analysis by incorporating exchange rate dynamics directly into the inflation equation, as suggested by Bertholet, Montes Rojas and Toledo (2025) and by Medina and Wlasiuk (2024).

There are several directions for further analysis that can easily be identified based on the above-mentioned discussion. One such area would be that related to the potential possibility of employing a similar empirical approach while conducting research into the period after 2023, when a larger dataset will have been obtained, and thereby analysing whether the unique nonconformist approach adopted by Argentina (namely, the application of stabilization measures) affects the dynamics and the way in which the monetary policy responds to it to the extent that it can be seen from the data. Another direction for further research could be associated with a comparative analysis between Argentina and its regional peers using an econometric method, thus measuring the degree to which each structural requirement affects the success of the experience with inflation targeting of the region in question.

It is also worth mentioning that the case of Argentina cannot be treated simply as an additional instance indicating the inefficiency of the regime. This particular instance may be viewed as the perfect natural experiment through which certain characteristics of economic structure and institution should be noted as the key preconditions for successful implementation of the strategy. In those cases where the necessary requirements are fulfilled, as it was done in five above-mentioned countries, the inflation targeting proved to be efficient in stabilizing the inflation in adverse economic conditions. However, in case if these conditions are lacking, the regime becomes inefficient showing the contrary results. The importance of this case study lies not only in the economic situation of Argentina, but may be helpful in indicating the situations where the strategy could be applied in other countries suffering from inflation for years.

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Appendix

A.1 Robustness Checks

This appendix reports the robustness checks for the empirical analysis presented in Chapter 3. The main analysis is based on a hybrid New Keynesian specification estimated by Ordinary Least Squares. To verify that the qualitative conclusions of the main analysis do not depend on the chosen econometric specification, alternative estimation strategies have been employed. The Taylor Rule has been re-estimated with a complementary specification including a lagged output gap and within an Autoregressive Distributed Lag (ARDL) framework with Newey-West HAC standard errors, which corrects for potential autocorrelation in the residuals. The Augmented Phillips Curve has been re-estimated within an ARDL framework with the lag length selected by minimising the Akaike Information Criterion (AIC), allowing the data to determine the optimal dynamic structure of the model. The results of these alternative specifications are reported in *Tables A.1* and *A.2*.

The robustness checks confirm the qualitative conclusions of the main analysis along all three substantive findings. First, the coefficient on inflation in the Taylor Rule remains positive and statistically significant with a magnitude well above unity, of an order that supports the interpretation of a mechanical correlation between elevated nominal rates and elevated inflation rather than evidence of compliance with the Taylor Principle. Second, the coefficient on the output gap remains negative and statistically significant across all specifications, consistent with the inversion of the standard interest rate–cycle relationship discussed in Chapter 3. Third, the Phillips Curve specifications confirm that inflation in Argentina is highly persistent and that this persistence did not decline after 2016, with the long-run inertia parameter rising substantially in the post-IT period. The convergence of these findings across estimation strategies strengthens the empirical foundation of the conclusions drawn in the main text.

Table A.1. Taylor Rule Estimation, Robustness check (Newey-West HAC) — Argentina
2000Q1–2026Q1

VARIABLES	Baseline	With lagged regressors
Inflation rate	7.0648***	6.7144***
	(0.7648)	(0.9217)
L1.Inflation rate	0.2978	1.4480
	(1.5768)	(2.4306)
L2.Inflation rate		-1.1533
		(1.2299)
Output gap	-0.7597***	-0.4740***
	(0.2860)	(0.1561)
L1.Output gap		-0.3954
		(0.3041)
IT dummy	1.1783	2.0085
	(4.9782)	(4.3196)
Constant	11.4395***	12.0562***
	(2.1437)	(2.4996)
Observations	104	103

Notes: Newey-West HAC standard errors are reported in parentheses.

*** p<0.01, ** p<0.05, * p<0.1.

Sample: 2000Q1 – 2026Q1.

Source: BCRA, OECD.

Table A.2. Augmented Phillips Curve Estimation, Robustness check (ARDL with AIC)
— Argentina 2000Q1–2026Q1

VARIABLES	Baseline ARDL (3,0)	Extended ARDL (3,0,0,4)
L1.Inflation	1.1604***	0.5928***
L2.Inflation	-0.5272***	-0.4800***
L3.Inflation	0.2121**	0.1300
Output gap	-0.0150	-0.0250
IT × L1.Inflation		0.5222***
R-squared	0.7705	0.8133
Observations	101	101

Notes: Standard errors are reported in parentheses.

*** p<0.01, ** p<0.05, * p<0.1.

ARDL lag length selected by AIC.

Sample: 2000Q1 – 2026Q1.

Source: BCRA, OECD.