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Applied Economics > Volume 42, 2010 - Issue 24

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A time-series approach to test a change in inflation persistence: the Mexican experience

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Pages 3067-3075 | Published online: 19 Mar 2008

66 Cite this article

▶ https://doi.org/10.1080/00036840801982684

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Abstract

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Acknowledgements

The opinions in this article correspond to the authors and do not necessarily reflect the point of view of Banco de México. We thank an anonymous referee, Carlos Capistrán and seminar participants at Banco de México, CIDE, Colegio de México and UDLAP for helpful comments, and to Mario Alberto Oliva for excellent research assistance.

Notes

¹ Formally, this is the result under adaptive expectations. The condition for the price level to be determinated under rational expectations is that the monetary authority should have a nominal anchor (Blanchard and Fischer, 1989). The existence of this anchor would imply that inflation cannot wander away from some value indefinitely, thus ensuring stationarity. Also note that the discussion has as a maintained assumption that nominal rigidities are present, so that monetary policy can have real effects in the short run.

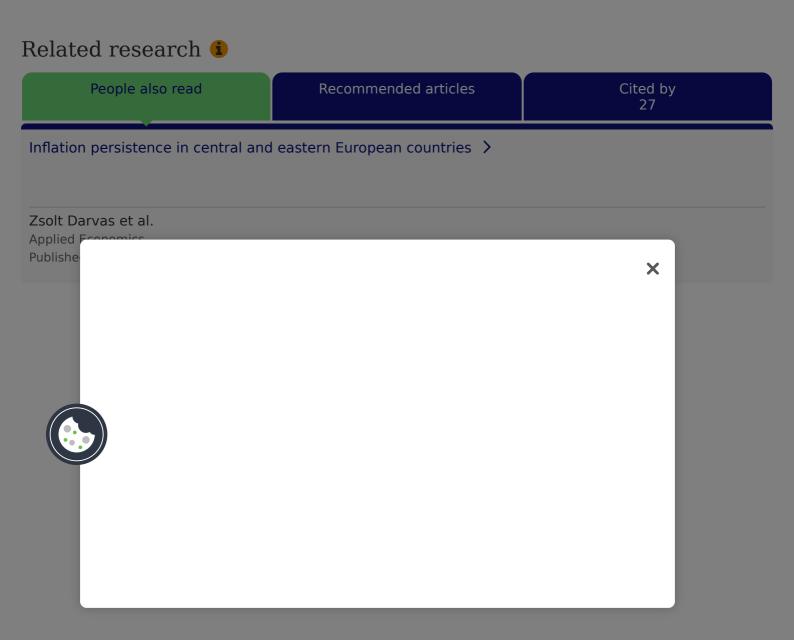
² Bernanke et al. (<u>1999</u>), Clarida et al. (<u>1999</u>) and Svensson (<u>1997</u>, <u>2000</u>) provide descriptions of the inflation-targeting framework. Under this regime, first-round effects of supply shocks are accommodated by monetary policy, while demand shocks and second-round effects of cost push shocks are not accommodated. On the other hand,

e inflation given ini target, i ³ There duction on 03) both the etti and docume Debe ⁴ Capist tion in

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Ramosprocess Francia and Torres (2005).

- ⁶ Examples of these more traditional procedures include testing for the stability of the sum of the coefficients on the lagged-dependent variable in an AR Model for inflation, or testing for shifts in the unconditional mean values of inflation, using structural change Models.
- ⁷ Capistrán and Ramos-Francia (2006) report: (i) a drastic drop in the mean and SD of inflation in Mexico for the period 2000–2006, compared to the previous two decades; (ii) evidence of a break in January 2001, which lowered the level of inflation; and (iii) a reduction in the sum of the autoregressive parameter from 0.95 in the period 1990–1999 to 0.31 in 2000–2006.
- ⁸ We do not discuss further these statistics as they are well known and implemented in popular software such as E-Views. For details, see Ng and Perron (2001).
- 9 Recall that the estimation of the change point is based on the M(X) $^{\rm R}$ statistic.



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