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Commodity Price Shocks and Inflation within An Optimal Monetary Policy Framework: The case of Colombia

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A small open macroeconomic model, in which an optimal interest rate rule emerges to drive the inflation behavior, is used to model inflation within an inflation targeting framework. This set up is used to estimate the relationship between commodity prices shocks and the inflation process in a country that both export and import commodities. We found evidence of a positive, yet small, impact from food international price shocks to inflation. However, these effects are no longer observable once the sample is split in the periods before and after the boom. The lack of effect from oil and energy price shocks we obtain supports the recent findings in the literature of a substantial decrease in the pass-through from oil prices to headline inflation. Thus, our interpretation is that monetary authority has faced rightly the shocks to commodity prices. Inflation expectations are the main determinant of inflation during the inflation targeting regime. Commodity prices movements are to a great extent included in the information set to form expectations.

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