

Determinants of inflation in Bolivia

Walter Orellana Rocha, Jorge Requena Blanco

ABSTRACT

After the severe hyperinflationary process experienced by Bolivian economy during the period of 1982-1985, exchange rate turned on the inflation anchor due its direct relationship with internal prices. In the past it was argued, when there were high rates of depreciation of domestic currency, that the transmission effect of depreciation to inflation was important. Nevertheless, it would have fallen to the extent that depreciation of Boliviano has been reducing.

In the paper are analyzed this hypothesis and other determinants of inflation in Bolivia through autoregressive vector models, which specification takes into account that Bolivian economy is a small, open, dollarized economy, exposed to supply shocks, mainly to agricultural sector. Besides quantifying of the impact of the rest of analyzed variables, on inflation, the work allows to conclude that there are few freedom degrees for a more active management of exchange rate. Findings show that the relationship between depreciation rate and inflation is non-linear. To the extent that transmission effect from depreciation to inflation be an increasing function of the depreciation of the nominal exchange rate, exchange rate policy should be addressed to maintain the stability of the real exchange rate in the medium term taking into account the constraint of not to expose to risk the internal prices stability.