Fiscal Populism and Monetary Policy Rules*

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Abstract

We explore the historical link between populist regimes, fiscal monetization, and inflation, and how these links affect monetary policy in the 21st century. Using data for a large set of advanced economies and emerging markets since 1960, we show that, historically, left-leaning populist regimes are linked to increases in central bank lending to the central government, a gauge of deficit monetization. In turn, central bank lending is associated with marked increases in inflation. We show that past exposure to populism that relied on deficit monetization affects the conduct of monetary policy *today*. Countries with a history of deficit monetization and left-wing populist regimes systematically respond more strongly to deviations of inflation expectations from target. This effect persists even after controlling for the direct effect of past inflation on monetary policy rules. In the context of the literature of experienced learning, this novel finding sheds light on the persistence of past populist policies—central banks operating under the shadow of past populist regimes that relied on inflation-prone deficit monetization continue today needing to send stronger signals of their independence and commitment to price stability to effectively anchor inflation expectations.

Keywords: Monetary Policy, Populism, Inflation Targeting, Fiscal Dominance, Past Inflation.

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1 Introduction

The global economy has recently witness three intertwined economic trends emerge—rising fiscal deficits, growing public debt levels, and a spike in inflation globally, and at the same time a rise in populist regimes. Fiscal concerns, which were already brewing prior to 2019, were exacerbated by the spending needs and recovery efforts during and after the COVID-19 pandemic. They are now being further impacted with growing military spending. Public debt levels have risen and risks to the debt outlook are heavily tilted to the upside IMF (2024). In turn, inflation rose in many countries since 2021, as supply bottlenecks and the fiscal response during the COVID-19 pandemic interacted with other global shocks that caused energy prices to increase, such as Russia's invasion of Ukraine. At the same time, further social discontent in the aftermath of the global financial crisis (GFC) sparked a wave of populism in both advanced and emerging markets and developing economies, to levels not previously observed (Funke et al., 2023). A key question going forward is how these forces may interact and reinforce each other. And what can be the medium- to long-term legacy of the current juncture.[1]

Against this backdrop, to address the above questions, this paper focuses on two interrelated issues: (1) How do populist regimes relate to fiscal outcomes, especially central bank financing of the central government, and, through this link, inflation? (2) How does past exposure to populist regimes associated with monetized fiscal imbalances influence future policy decisions? To answer them, we combine a novel database of populist regimes of about 60 countries from Funke et al. (2023) with data on central bank lending to the central government from the IMF's central bank (non-standardized) survey, and data on inflation for the 1960-2008 period. We also include quarterly data on policy rates, inflation expectations, inflation targets, economic activity, and exchange rates for 32 inflation targeting countries. With this information at hand, we first estimate the dynamic association between having a populist leader and central bank lending to the central government, on the one hand, and then the dynamic association between central bank lending to the central government and inflation, on the other, using local projection methods (Jordà, 2005).

The analysis is motivated by the fact that populism is not a new phenomenon. Indeed, populist regimes were relatively common between 1940 and 1980, suggesting that looking at historical data can shed light on the potential links between populist regimes, central bank lending, and inflation. Moreover, central bank lending to the central government is a clear measure of deficit monetization, which has been found to be associated with inflationary episodes (Sargent and Wallace, 1981). Next, we develop a more novel contribution: we exploit this historical data and, in the context of the literature of experienced learning, we estimate how exposure to past populist regimes with high central bank lending shape *current* monetary policy reaction functions among inflation targeting countries.

[1] To be sure, the link between fiscal imbalances and inflation is well understood (see Sargent and Wallace, 1981). Similarly, recent literature has documented the macroeconomic consequences of populism (Funke et al., 2023; Magud and Spilimbergo, 2021). However, less is know about the ways in which these forces interact and what could its potential legacy could be.

We find that, historically, populist regimes—especially those classified as left-leaning—are associated with a significant increase in central bank lending to the central government. Using the dif-in-dif local projection method proposed by Dube et al. (2025), we show that the emergence of a new populist regime results in a 150 percent cumulative increase in central bank credit 10 years after the populist government takes office, albeit effects are not statistically significant. However, when we zoom into different types of populist regimes, as classified in Funke et al. (2023), we find different patterns. While the emergence of right-wing populist governments is linked to moderate and insignificant growth on central bank credit, central bank credit grows substantially, and in a statistically significant way, in the aftermath of left-wing populist governments taking office—300 percent cumulative growth in central bank credit, on average, 10 years after the populist government takes office. Results are consistent with past evidence that left-wing populist regimes tend to expand government expenditure, especially if one of their goals is to focus on domestic demand and redistributive policies, objectives that are typically attributed to left-leaning government. We further illustrate the connection between populist regimes and central bank credit to central government by identifying periods of unusually high central bank credit. This is done by identifying periods where central bank credit to the government exceeds the country-specific average by two standard deviations. We then estimate how the likelihood of these events relate to the country's past exposure to left-wing and right-wing populist regimes, respectively, and find that higher exposure to left-wing populism increases the likelihood of experiencing a high central bank credit episode, while exposure to right-wing populism reduces it.

We also find that increases in central bank credit to the central government are associated with an increase in inflation (Sargent and Wallace, 1981). A one-standard deviation increase in central bank credit yields an increase in inflation which peaks at 1 percentage point, on average, two years after the increase in central ban credit. In turn, the increase is linked to a 4 percent cumulative increase in prices after 10 years, relative to a country that did not experience an increase in central bank credit. The short-term link between central bank credit and inflation is even stronger, albeit relatively short-lived, when a country experiences an episode of unusually high central bank credit, as defined above. Inflation increase by about 4 percentage points on impact and prices increase a cumulative 10 percent 5 years after the shock. Taken together our results illustrate the link between populism, deficit monetization and fiscal dominance, and inflation.

Beyond short-term effects, exposure to populism and deficit monetization can affect monetary policy in the medium- to long-term. Building on Jácome et al. (2025b), we estimate the role played by past exposure to populism and high levels of central bank credit to the central government on the conduct of monetary policy in a sample of countries with central banks currently following an inflation targeting regime. Consistent with our results analyzing historical patterns, we find that central banks in countries with a past experience of left-wing populism and high levels of central bank credit (deficit monetization) respond more forcefully to deviations of inflation expectations from the target. This finding is robust to alternative

specifications, additional controls, and different fixed effects configurations. Importantly, results are not fully explained by the country's past inflationary history. We interpret this as central banks in countries with past exposure to populism and deficit monetization having to assert their independence by responding more forcefully to signs of inflation deanchoring. That is, in the context of the literature of experienced learning, we stress the persistent effect of past populist policies: central banks operating under the shadow of past populist regimes that relied on deficit monetization continue, even today, need to send stronger signals of their independence and commitment to price stability to effectively being able to anchor inflation expectations and contain inflationary pressures.

Literature Review. This paper contributes to several strands of the literature. First, it contributes to a large literature on inflation targeting, which flourished in the 2000s up until the GFC. Ball (2010), Svensson (2010), and Walsh (2010) summarize three important results from these studies: (i) inflation targeting, when compared to non-inflation targeting countries, has made a difference in terms of achieving low and stable inflation in emerging market economies, but not so much in advanced economies[2]; (ii) an explicit inflation target stabilizes inflation expectations and help handle supply shocks; and (iii) inflation targeting has not been associated with output growth but can reduce output volatility in emerging market economies. Interest in studying inflation targeting subsided in the aftermath of the GFC, as inflation plummeted and attention shifted to assessing the effects of the unconventional monetary policies, but re-emerged after a surge of inflation following the Covid pandemic. Recent papers include Guerra et al. (2025), who explore changes in Taylor rules in the aftermath of COVID among Latin American countries, Zhang and Wang (2022), which highlights the effects of the inflation-targeting countries' track record on macroeconomic outcomes, Bhalla et al. (2023) that revisit the impact of adopting inflation targeting on anchoring inflation expectations in a sample of advanced economies and emerging markets and developing countries, and find better outcomes on early inflation-targeting adopters, and Duncan et al. (2022) that focuses on assessing the effectiveness of inflation targeting in the same type of countries, and find stronger results in emerging markets and developing countries.

Our work diverges from most previous papers in an important ways. Those studies rest on the premise that inflation-targeting countries are a homogeneous group and, thus, conduct monetary policy in a uniform manner. In contrast, our study digs into the differences observed among inflation-targeting countries aiming at unveiling whether their economic and institutional features and heterogeneity help to explain the way central banks conduct monetary policy. In this sense, this paper relates to Jácome et al. (2025a) and Jácome et al. (2025b), who explore monetary policy heterogeneity among ITs with respect to their past inflation experiences.

[2]For example, Ball and Sheridan (2005) find no evidence that the adoption of an inflation targeting regime improves macroeconomic outcomes among advanced economies. By contrast, Goncalves and Salles (2008) find evidence that, among emerging markets, IT countries exhibit lower and less volatile inflation compared to non-IT countries. Similar results are found by Lin and Ye (2009), although the authors find that the extent to which IT is associated with lower inflation varies according to the country's fiscal position, the central bank's desire to limit the movements of exchange rate, its willingness to meet the preconditions of policy adoption, and the time length since the policy adoption.

Our analysis relates, alternatively, to a growing literature that underscores the importance of inflation history on individuals' inflation expectations. This include Malmendier and Nagel (2016), which documents that older individuals in the US tend to have higher inflation expectations, Salle et al. (2023) who show that people that experienced past episodes of high inflation have higher inflation expectations, Magud and Pienknagura (2025) who show that cross-country cohorts of individuals (going back to those born in the early 1920s) that were exposed to longer bouts of high inflation were more averse to inflation in general and in particular to unexpected inflationary shocks, and Gennaioli et al. (2024) that document that in the US, during the COVID inflation shocks, older people expected higher inflation rates than younger individuals. Relatedly, Malmendier and Nagel (2011) show how individuals that experienced the great depression in the US were more risk averse—including staying away from investing in the stock market (see also (Malmendier, 2021)), whereas Binder and Makridis (2022) find that individuals that experienced the 1970s oil shocks in the US had higher inflation expectations than other people, and Giuliano and Spilimbergo (2023, 2024) that document the role of aggregate shocks in individuals' expectations. All these studies focus on individuals' expectations as driven by personal experience. Instead, our work focuses on the policymaking side. It could thus be more closely associated with Malmendier et al. (2021) that show how FOMC policymakers that were exposed to high inflation when younger in other countries tend to systematically vote for more hawkish policy decisions.[3] Our paper takes for granted individuals' reaction and implicitly assesses how the policymaker internalizes aggregate choice. Along these lines, from a theoretical perspective, our analysis in consistent with Rogoff (1985) who, in the context of simple Barro-Gordon model, shows the need for a central bank that is more conservative (in terms of monetary policy preferences) than the average individual (see also Afrouzi et al., 2024, for a similar point). Recent work by Bocola et al. (2025) focuses on how, in the presence of uncertainty about the type of central banker (dove vs. hawk), it may be optimal for interest rates to react more strongly to demand and supply shocks to signal their type and thus strengthening the reputation of central bank to mitigate inflation expectations de-anchoring. Different from our work, however, they focus on monetary policy interest rate shocks' impact on inflation expectations.

Our paper also relates to the literature exploring the links between fiscal policy, monetary policy and inflation. The works of Sargent and Wallace (1981) and, more recently, Cochrane (2023) illustrate the role of fiscal policy in affecting prices. Kehoe and Nicolini (2021) case studies and Jácome and Pienknagura (2026) illustrate this link in the context of Latin America. This paper adds to this literature by zooming into the role that populist regimes play in this link, and how this affects monetary policy.

Finally, our work adds to the work on the link between populist regimes and economic outcomes. Dornbusch and Edwards (1990a,b) highlighted the role played by populist governments in the macroeconomic imbalance experienced by Latin American countries in during the

[3] Erceg and Levin (2003) study theoretically the role of imperfect credibility of the inflation target rather than the degree of credibility as reflected in how well-anchored inflation expectations are (that is, the gap between expected inflation and the inflation target), as we do.

1960s-1980s. More recently, Funke et al. (2023) and Magud and Spilimbergo (2021) borrow the definition of populism from the political science literature, which decouples the definition of populism from economic outcomes, to assess how populist regimes affect macroeconomic and institutional outcomes. We add to these works by zooming into the relationship between populism and deficit monetization and studying how this affect monetary policy in the long-term.

The rest of the paper is structured as follows: Section 2 presents as observed motivation the experience of Argentina. Section 3 describes the empirical specification used to conduct the analysis and the data feeding the study; Section 4 discusses the main results; Section 5 distills the main conclusions of the paper.

2 Case Study. The Looking Glass into Argentina's Experience: Populism, Fiscal Dominance, and Inflation in Argentina

Argentina offers a unique and rich laboratory to discuss how populist governments implemented fiscal policy, the monetary financing, and their impact on inflation. Argentina has history of political instability encompassing both democratically and authoritarian regimes, led by political parties but also by military dictatorships, with right-win and left-wing political orientation, in most cases featuring a populist stance. This [section] examines the evolution of monetary financing of fiscal policy in Argentina and the costs it inflicted on inflation, highlighting the role played by populist governments that were in office during this period. It also identifies key legal reforms, which laid the ground for the BCRA's monetization of fiscal expenditure.

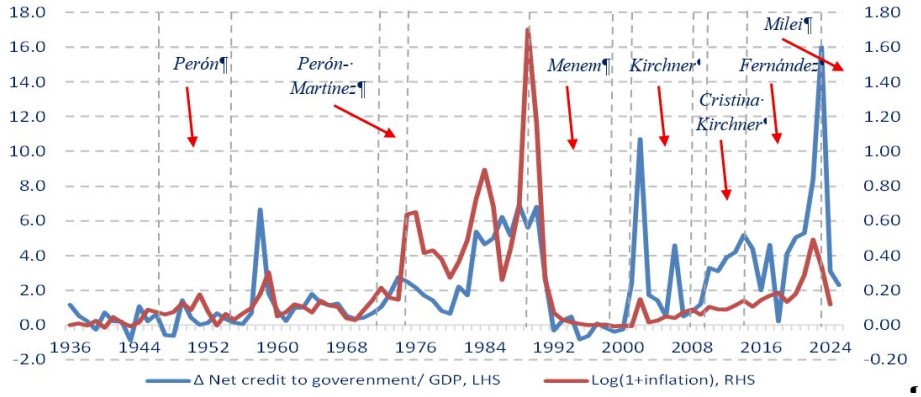
Building on Funke et al. (2023) database and also including the last two governments, which can be characterized as populist according to the definition used in this paper, Argentina features seven episodes of populism starting in the mid-1940s, when the central bank had already been established.[4] Five of them are left-leaning and the other two right-leaning: Perón, 1946–1955 (left); Perón–Martínez, 1973–1976 (left); Menem, 1989–1999 (right); Néstor Kirchner, 2003–2007 (left); Cristina Kirchner, 2007–2015 (left); Fernández, 2019–2023 (left); and Milei, 2023–2025 (right). In all these episodes, fiscal policies, either expansionary or contractionary, were a common feature and, in most cases, the Central Bank of the Republic of Argentina (BCRA) was an important source of financing.

Fiscal policy implemented by left-wing governments relied on central bank financing, whereas right-wing governments did not (see Figure 1).[5] BCRA's monetary policy shows a history of fiscal dominance, except for its first 10 years of existence, and for the Menem and Milei periods. In turn, extended fiscal dominance was a key driver of the historical erosion of the BCRA's political independence, which ultimately undermined monetary credibility, thus hindering anti-

[4] Funke et al. (2023) also identifies two previous episodes of populism, namely between 1916 and 1922 and during 1928–1930.

[5] The 1980s is an exception, as the government and, especially, the BCRA, implemented policies to confront a systemic banking in the early part of the decade, printing money profusely to pay depositors and bailout banks (see, for example, Baliño (1991)

Figure 1: Argentina. Credit to the government and inflation (1936-2025)
(in percent of GDP and log (1+inflation))



Notes: This figure plots the net central bank credit to the government (in percent of GDP) and the (1+log) inflation in Argentina duting 1936-2025.
Source: Central Bank of Argentina.

inflation efforts.[6] Against this background, inflation tended to rise when the BCRA increased government financing and to decline when such financing subsided.[7]

2.0.1 Key reforms to the BCRA Law modifying government financing

The BCRA was established in 1935 (Law 12.155) with a high degree of independence from the political powers.[8] It was only authorized to provide transitory advances to the government—not to the rest of the public sector. The amount of these advances could not exceed 10 percent of the average revenues received by the government in the previous three years and could only purchase government paper in the secondary market with a 20 percent haircut with specific limits. The advances had to be paid back within the next twelve months of their disbursements. This credit facility was conceived with the aim of helping the government to cope with temporary or seasonal revenue shortages. Other forms of credit to the government were forbidden. From then on, its legislation was modified seven times to make room to finance public sector expenditure or to limit the central bank's capacity to print money to fund fiscal expenditure.

Law 12.962 from October 1946

The first reform was approved with the main purpose of nationalizing the BCRA—making it a state-owned institution—and to assign monetary policy an expanded mandate. This new mandate included "to promote, guide, and carry out, to the extent of its legal powers, the appropriate economic policy to maintain a high level of activity that ensures the maximum

[6]The BCRA is historically one of the worst performers compared to other central banks in Latin America, measured by indices of central bank independence (see Jácome (2026).

[7]The hyperinflation years are not the result of populist policies, at least in Argentina, but rather of high inherited external debt, the loss of access to international credit markets in the decade following the Volcker disinflation, and stabilization attempts undertaken without fiscal adjustment.

[8]See in Jácome (2026) a historical perspective of the BCRA's institutional features.

employment of available human and material resources and the orderly expansion of the economy, with a view to ensuring that the growth of national wealth allows for an improvement in the standard of living of the Nation's inhabitants." This mandate was in sync with a developmental role assigned to the BCRA at that time.

The new legislation made room for printing money to finance not only the government, like in the previous law, but also the public sector, in general. The reform also involved restructuring its governance arrangement to give the government the control of monetary and exchange rate policy—ten out fifteen members of the Board were either appointed by, or were ex-officio members representing, the government.

Law 25.120 from October 1949

A new organic law was approved in 1949. The law expanded the BCRA's space to finance the government via transitory advances to no more than 15 percent of the average revenues received by the government in the previous three years. Like in the previous law, the advances had to be paid back within the next twelve months of their disbursements. Increasing central bank financing to the government was part of a broad economic policy strategy that envisaged a larger government role on economic activities.

This legislation aimed at consolidating the developmental role of the BCRA's monetary policy and its control by the government. It was a time of a global trend toward greater government involvement in the economy that reflected the disenchantment with the liberal policies that prevailed in the run-up and during the Great Depression.

Decree Law 13.126 from October 1957

The 1957 law reversed only partially the developmental character assigned previously to the BCRA. While it reversed the "nationalization of deposits" introduced in 1946—a recognition that it that had stifled financial intermediation and the development of the banking system—, it reintroduced the policy mandate of promoting an "ordered and persistent economic growth," which created policy conflicts.

The BCRA was authorized to provide transitory advances to the government up to 15 percent of the revenues received by the government in the last 12 months. The advances had to be paid back within the next twelve months of their disbursements. Because Argentina was already going through high inflation, reducing the cap on the advances, from the average of the last three years to the last 12 months, entailed an increase in the government access to central bank money.

Law 20.539 from October 1973

With the advent of a new government in 1973, central bank legislation experienced a comprehensive reform by which the BCRA's independence was further eroded. This law expanded even further the BCRA's financing to the government via transitory advances, increasing the cap to 30 percent of the average revenues received by the government in the last 12 months. Like before, due to the temporary nature of these advances, they had to be paid back within the

next twelve months of their disbursements. Doubling the cap on central bank financing to the government was consistent with the expansionary fiscal policy implemented by the government, which required easy and cheap financing. Legislation capped the maximum interest rate to be charged for these advances to well below market rates.

The new law also nationalized bank deposits once again. The executive power took control of BCRA's policies as they became subject to the directives issued by the Ministry of Finance. The BCRA's mandate was expanded even further to include several objectives such as maintaining an ordered and growing economic development with a social approach, high occupation, and a stable currency.

Law 24.144 from September 1992

This legislation provided an alternative approach to government financing by the BCRA. Instead of allowing the provision of temporary advances to the government, it authorized the BCRA to finance the government through the purchase of marketable securities, at market values, with limitations. The growth of the BCRA's government bond holdings, at face value, could not be more than 10 percent for a calendar year, or exceed 1/3 of total freely available international reserves as defined by the Convertibility Law.

The new legislation aimed to secure the BCRA's political independence and to align its responsibilities to the functioning of the Currency Boar Arrangement (CBA). It specifically determined that the BCRA's primary and essential mission was to preserve the value of the currency and that in pursuing this objective it will not be subject to orders from the executive power. The BCRA's board was restructured, such that its members would not represent either the public or the private sector. Board members had to be confirmed by the Senate and could not be removed without its approval.

Law 25.780 from August 2003

The collapse of the CBA gave rise to a new round of reforms of the central bank law. The 2003 reform reestablished provisions that authorized the central bank to finance the government, while the BCRA's mandate and its governing arrangement remained the same. This time this financing could not exceed 10 percent of the revenues received by the government in the last 12 months. In addition, the outstanding balance of these advances would not be more than 12 percent of the monetary base, excluding the credit granted to pay obligations to international multilateral institutions. While all advances were due within the next twelve months of their disbursements, like in previous legislations—except for the 1992 law—, the interest rate to be charged for these funds was not specified in the law.

Law 26.739 from March 2012

Finally, a new central bank law was approved in 2012. This legislation deepened fiscal dominance. It authorized the BCRA to extend transitory advances to the government up to an amount equivalent to 12 percent of the monetary base and, in addition, to provide advances

of up to 10 percent of the government revenues in the last 12 months. Like in the previous legislation, advances were due within the next twelve months of their disbursements and no interest rate for these funds was specified. On top of this financing, the law authorized the BCRA to extend another 10 percent of the revenues in cash obtained by the government in the last 12 months, whenever extraordinary domestic or international conditions emerge. This extra financing would need to be paid back in the next 18 months of their disbursement.

The new legislation severely undermined the BCRA's independence. Once again, the central bank mandate was assigned conflicting objectives. It was required to promote employment and economic development with social equity, together with monetary and financial stability, along the lines of the economic policies defined by the government.

Although Argentina is not part of the sample of current inflation-targeting countries used in the empirical analysis below, it provides a clear historical illustration of the mechanism emphasized in this paper (populism, deficit monetization, and inflation), which motivates the analysis that follows.

3 Econometric Strategy and Data

This section describes the empirical methods used to estimate both the link between populism, central bank credit, and inflation, and central banks' monetary policy reaction function, and the data sources used in the analysis and their limitations. As explained above, when estimating countries' monetary policy reaction functions, we take the advantage of the homogeneous framework for the conduct of monetary policy in the countries in our sample, namely inflation targeting, while exploiting the heterogeneity with respect to their past inflationary history and several other state variables.

3.1 Econometric Specification

The paper's analysis is split into two distinct set of exercises. The first set exercise explores the link between populism, central bank credit to the central government, and inflation. To do so, we follow the local projections method proposed by Jordà (2005) and the local projections dif-in-dif methodology proposed by Dube et al. (2025). In particular, we first estimate a regression exploring the link between central bank lending and inflation, as follows:

$$p_{c,t+h} - p_{c,t-1} = \alpha_c + \tau_t + \beta CBL_{c,t} + \sum_{j=1}^{3}(\gamma \pi_{c,t-j} + \omega CBL_{c,t-j} + \rho PB_{c,t-j}) + \varepsilon_{c,t} \qquad (1)$$

where p is the log of the price level, CBL is the growth of central bank claims to the central government,[9] π is the inflation rate, and α, τ are country and time fixed effects, respectively.

[9] We also regress this specification using a dummy taking value one if there is an episode of abnormal increase in central bank credit to the central government instead of the growth rate of the claims. See details below.

PB is the primary balance.

We turn next to exploring the link between populist regimes and central bank lending. We do so by identifying changes in political regimes, from non-populist to populist, and compare changes in central bank lending in the aftermath of these changes. Importantly, as suggested by Dube et al. (2025), we focus on clean controls (countries that have not experienced populist governments in the past five years nor in the projection horizon) and on clean treatments (countries that experienced a first time change into a populism in five years). With that sample, we estimate two specifications. The first treats all populist governments equally, as follows:

$$CBL_{c,t+h,t-1} = \alpha_c + \tau_t + \beta POP_{c,t} + \sum_{j=1}^{3}(\gamma_j \pi_{c,t-j} + \omega_j CBL_{c,t-j,t-j-1} + \rho PB_{c,t-j}) + \varepsilon_{c,t} \quad (2)$$

where $CBL_{c,t+h,t-1}$ is the log difference of central bank claims on the central government between periods $t+h$ and $t-1$, POP is a dummy taking value one if the country experienced a regime change from a non-populist government to a populist one and, as above, PB is the primary balance.

In addition, we extend equation 2 by differentiating between left-leaning populist regimes and right-leaning ones. In particular, we estimate:

$$\begin{aligned} CBL_{c,t+h,t-1} = \alpha_c + \tau_t + \beta_L LPOP_{c,t} + \beta_R RPOP_{c,t} + \\ \sum_{j=1}^{3}(\gamma_j \pi_{c,t-j} + \omega_j CBL_{c,t-j,t-j-1} + \rho PB_{c,t-j}) + \varepsilon_{c,t} \end{aligned} \quad (3)$$

where, as before, $LPOP$ and $RPOP$ are dummies taking value one if the country experienced a regime change from a non-populist government to a left-leaning populist one and from a non-populist government to a right-leaning populist one, respectively.

A second set of regressions zooms into IT central banks' monetary policy functions and their link with past country experiences with populism, inflation, and fiscal imbalances. We first estimate Taylor rules through a panel approach. The baseline specification takes the following form:

$$\begin{aligned} i_{c,t} = \alpha_c + \rho i_{c,t-1} + \beta \pi gap_{c,t} + \gamma Ygap_{c,t} + \\ \theta \Delta NEER_{c,t} + \mu \Delta NEER_{c,t-1} + \omega i_{US,t-1} + \varepsilon_{c,t} \end{aligned} \quad (4)$$

where $i_{c,t}$ is the policy rate in country c, at time t, α_c is a country fixed effect, $Ygap_{c,t}$ is the output gap in country c at time t, which is calculated using the HP filter, $\Delta NEER_{c,t}$ is the change in the nominal effective exchange rate in period t, $i_{US,t-1}$[10] is the monetary policy

[10]In some exercises we expand the baseline specification by replacing the US monetary policy rate with time fixed effect aimed at capturing global factors, beyond financial conditions, affecting all countries in our sample.

rate in the US at time $t-1$, and $\pi gap_{c,t}$ is the inflation gap in country c at time t. Following Jácome et al. (2025b), the inflation gap is based on the deviation of one-year ahead inflation expectations from the central bank's inflation target, in spirit to the theoretical underpinnings behind the Taylor rule (Svenson, 1997)—see Subsection 3.2 for specifics of how the inflation gap is constructed. The inclusion of the output and inflation gaps follows the standard Taylor rule formulation. We augment the standard Taylor rule by including changes in the nominal exchange rate and by controlling for the US monetary policy rate, two important variables for small open economies (Ghosh et al., 2015), and the lagged interest rate to smooth for interest rate persistence.

As is well known, the estimates of the Taylor rule from OLS panel estimations are expected to be biased. However, as shown by Carvalho et al. (2021) the bias is likely small, and OLS outperforms IV under realistic sample sizes. The endogeneity is driven by the correlation between the regressors and the equation's error term. That is, an asymptotic bias. As is known, estimation via IV or GMM would solve the endogeneity problem. Carvalho et al. (2021) show theoretically , however, that in practice, finding suitable instruments is difficult. They stress how lagged endogenous variables cannot be used given the persistence of monetary policy shocks. To this end, Carvalho et al. (2021) show that OLS asymptotic estimation bias is proportional to the fraction of the variance of the regressors that comes from monetary policy shocks. This variance is known to account for little of the variance of the regressors. Moreover, they document that, despite the endogeneity bias, OLS outperform GMM estimates. Specifically, OLS estimates' bias is of similar magnitude to GMM, but with higher precision. Moreover, IRFs estimated by OLS are similar to the true model, while the range of a Monte Carlo exercise of OLS IRFs is narrower than that of a GMM estimation. Additionally, de Vries (2013) look into the magnitude of IV estimation bias in the presence of correlated monetary shocks. They find that the endogeneity bias in the conventional three-equation NK estimation of Taylor rules are not large.

In some exercises we also include the years as an IT for each central bank,[11] aimed at capturing the potential evolution in the conduct of monetary policy as central banks become more established inflation targeters.

To study heterogeneity in the conduct of monetary policy across IT central banks we estimate a variant of equation (4) which allows the coefficients for the inflation and the output gaps to vary with the country-specific variables, in particular, variables capturing inflation path-dependence. More precisely, we estimate the following equation:

$$\begin{aligned} i_{c,t} = \alpha_c + \rho i_{c,t-1} + \beta \pi gap_{c,t} + \gamma Ygap_{c,t} + \sum_{f \in F} z_c^f (\delta_f \pi gap_{c,t} + \tau_f Ygap_{c,t}) + \\ \theta \Delta NEER_{c,t} + \mu \Delta NEER_{c,t-1} + \omega i_{US,t-1} + \varepsilon_{c,t} \end{aligned} \tag{5}$$

where z is a variable indicating whether fundamental $f \in F = \{$financial development, trade openness, capital account openness, central bank independence, past inflation, past populist

[11] This is controlled for in two ways—as a linear function of the years as an IT and as fixed effects.

regimes, past episodes of central bank lending} was high at the time of IT adoption. Of special relevance for this paper, is the focus on the interaction with past episodes of populist regimes and with past episodes of central bank lending.

3.2 Data

We rely on several data sources to conduct the econometric analysis discussed above. Data on inflation expectations come from consensus forecasts collected by Consensus Economics. These are survey-based inflation forecasts from professional forecasters. The number and type of forecasters considered in the surveys varies by country. But there are alternative ways to measure inflation expectations. Compared to household or firm surveys gauging inflation expectations, the data from consensus forecasts has the advantage that is consistently collected for a large sample of countries and is available for an extended time period. Moreover, there is evidence that household inflation expectations as measured in surveys could be sensitive to the way that survey questions are formulated and/or to inadvertent nudging and priming (Weber et al., 2022). Sampling and low response rates can also be an issue, particularly for firm surveys, for which the opportunity cost of responding is high.[12]

Data on inflation targets and policy rates are collected from the BIS, and in the case of targets, complemented using information reported in the IMF's Annual Report on Exchange Arrangements and Exchange Restrictions (AREAER). In the case of countries reporting a target band, we use the mid-point of the band as our gauge of the target.

Data on nominal effective exchange rates and inflation come from the IMF's International Financial Statistics (IFS). Output gaps are computed using quarterly real GDP information from national sources retrieved by using Haver analytics. Data are seasonally adjusted by either national authorities or, if not available, by using Haver's seasonal adjustment. The output gap is calculated using the HP filter.

Data used to explore cross-country heterogeneity in monetary policy responses come from several sources. To gauge a country's financial development we use the index proposed by Svirydzenka (2022) and Sahay et al. (2015). This is an index summarizing how developed financial institutions and financial markets are in terms of their depth, access, and efficiency. We proxy trade openness by using the trade over GDP ratio reported in the World Bank's World Development Indicators (WDI). Data on central bank independence comes from Romelli (2022, 2024). The index summarizes information on 6 dimensions of central bank independence: (i) governor and central bank board, (ii) monetary policy and conflict resolution, (iii) objectives, (iv) limitations on lending to the government, (v) financial independence, and (vi) reporting and

[12]One potential drawback of surveys filled by experts is that their forecasts may not be reflective of those of the relevant economic agents (consumers, workers, firms). There are also potential biases introduced by incentives for respondents not to reveal their true beliefs (Coibion et al., 2018). Yet, empirical work suggests that expectations by professional forecasters and firms have better predictive power as far as current inflation is concerned relative to (median or average) household expectations (IMF, 2023) and there are also biases in household and firm surveys, which may reflect the possibility that these agents pay less attention to policy announcements (Weber et al., 2022).

disclosure. Capital account openness comes from the Chinn and Ito (2006)'s capital account openness (KA openness) index. In some exercises, we complement the KA openness index with data on foreign exchange rate interventions (FXI) from Adler et al. (Forthcoming), which allows to correct for the fact that countries with an open capital account may intervene, in some cases very frequently, in FX markets. We use the classification in Aslam et al. (2016) to identify commodity exporting countries.

Finally, and critical to this paper, we rely on several data sources to study the link between populism, central bank financing to the central government, and inflation. Data on populist regimes comes from Funke et al. (2023), who rely on several sources from the political science literature to classify regimes as populists. Building on the workhorse definition in political science, the authors define a leader as populist if he or she divides society into two artificial groups—"the people" versus "the elites"—and then claims to be the sole representative of the true people. The authors further distinguish among populists by identifying left-wing populists—those attacking economic elites—and right-wing populists—those attacking foreigners and minorities, and the political elites protecting them.[13]. Data on central bank claims on the central government, a gauge of central bank financing, comes from the IMF's non-standardized central bank survey (which allows us to have a time-series dating back to the 1960s). In addition to using the raw data, we identify events of abnormal increases in central bank financing.[14] To do so, we calculate the year-on-year growth of the nominal value of central bank claims on the central government and identify episodes where the growth rate exceeds the country-specific mean by two standard deviations. Historical data on the primary balance are from Mauro et al. (2015). Finally, data on inflation comes from the World Bank's World Development Indicators (WDI). We use the historical inflation data in two ways. First, we use it to run regressions assessing the link between increases in central bank credit to the central government and inflation. Second, we calculate a gauge of past exposure to high inflation as follows. For each country, we compute the average inflation rate from either 1960, or the first year for which the country appears in WDI, to ten years before the adoption of the IT regime. Using this information, we compute two variables: one is a dummy variable taking value one if the country had an average historical inflation above the 75th percentile value in our sample (that is, above the 75th percentile of every observed country-year rate of inflation), and the other is a continuous transformation of the historical average inflation that compresses the distribution to account for countries that

[13]As discussed in Funke et al. (2023), the defining feature of left-wing populists is that their anti elitism is predominantly framed in economic terms. Left-wing populists frequently attack financial, capitalist, oligarchic elites who supposedly plunder the country at the expense of the people. They often rally against globalization, banks, multinational companies, and international financial institutions. By contrast, right-wing populists predominantly frame their populist discourse in cultural terms and target a third group—foreigners and ethnic and religious minorities, who supposedly threaten the national identity and culture. They often accuse "the elites" (who are first and foremost political elites) of protecting these minorities against the will of "the people".

[14]This is important because central bank financing to the government was a common practice in most countries in the world until the 1990s. Leone (1991) surveys central bank lending to the government and its legal restrictions in more than 100 countries. Printing money to finance the government was particularly consequential in Latin America, where it started at the time of the Great Depression and then took hold from the 1940s onward during the"developmental phase" of central banks (Jácome, 2015, and Jácome (2026)

experienced hyperinflation. The transformation, which computes $\pi = \pi/(100 + \pi)$, has been used in Jácome and Pienknagura (2026) and Acemoglu et al. (2008). Again, inflation is classified as high in the latter computation for a country is above the 75th percentile of the entire country-year distribution in our sample.

4 Results

This section presents the two main empirical results of the paper. First, it explores the link between populism, fiscal imbalances, and inflation. Then, it presents an empirical exploration of how the legacy of populism, fiscal imbalances and inflation can shape monetary policy among IT central banks.

4.1 Populism, Central Bank Lending, and Inflation

Understanding the economic consequences of populism has been a subject that has garnered attention for several decades. The seminal work of Dornbusch and Edwards (1990a,b) introduced the concept of economic populism and illustrated the adverse medium-term consequences of populist policies.[15] One challenge of the of work by Dornbusch and Edwards is that their definition of populism is tightly linked to macroeconomic performance, making it difficult to disentangle populism from key outcome variables. More recently, Magud and Spilimbergo (2021) and Funke et al. (2023) have revisited the link between populist regimes and macroeconomic performance by relying on a definition of populism emanating from the political science literature. Broadly speaking, these definitions define governments as populist when their rhetoric pits society ("the people") against another group (elites, immigrants, corporations, etc.). An appealing feature of this approach is that it de-links the definition of populism from macroeconomic outcomes. Notwithstanding the differences in definition, results in Funke et al. (2023) and Magud and Spilimbergo (2021) point to fiscal imbalances (larger fiscal deficits and increased debt) and macroeconomic underperformance (lower GDP) in the aftermath of populist regimes.

We zoom into the relationship between populism, fiscal policies, and inflation by focusing on a very specific fiscal outcome—the role of central bank lending to the central government. This is a gauge of monetization of government deficits which can help understand the specific channels through which populist governments can affect macroeconomic performance. In particular, we rely on data from the IMF's survey reporting central bank claims on the central government. This captures the gross stock of central government debt held by the central bank. We then compute the year-on-year change in the stock, as a way to capture financing, and identify periods of abnormal increases in central bank lending.

We begin by documenting the link between populist governments and central bank credit. Figure 2 shows the change in central bank credit in the aftermath of a new populist regime

[15] The authors define populist policies as "an approach that emphasizes growth and income redistribution and de emphasizes the risks of inflation and deficit finance, external constraints and the reaction of economic agents to aggressive non-market policies."

taking office. We do so by following Dube et al. (2025), which proposed the local projection dif-in-dif method. The method features the construction of clean controls (countries that have not experienced populist regimes in the years prior the treatment nor in the projection horizon) and clean treatments (countries that experience only one treatment over the projection horizon). In this sense, the figures illustrate the differential growth of central bank credit in treated countries (those with newly installed populist governments) relative to countries not experiencing populist regimes.

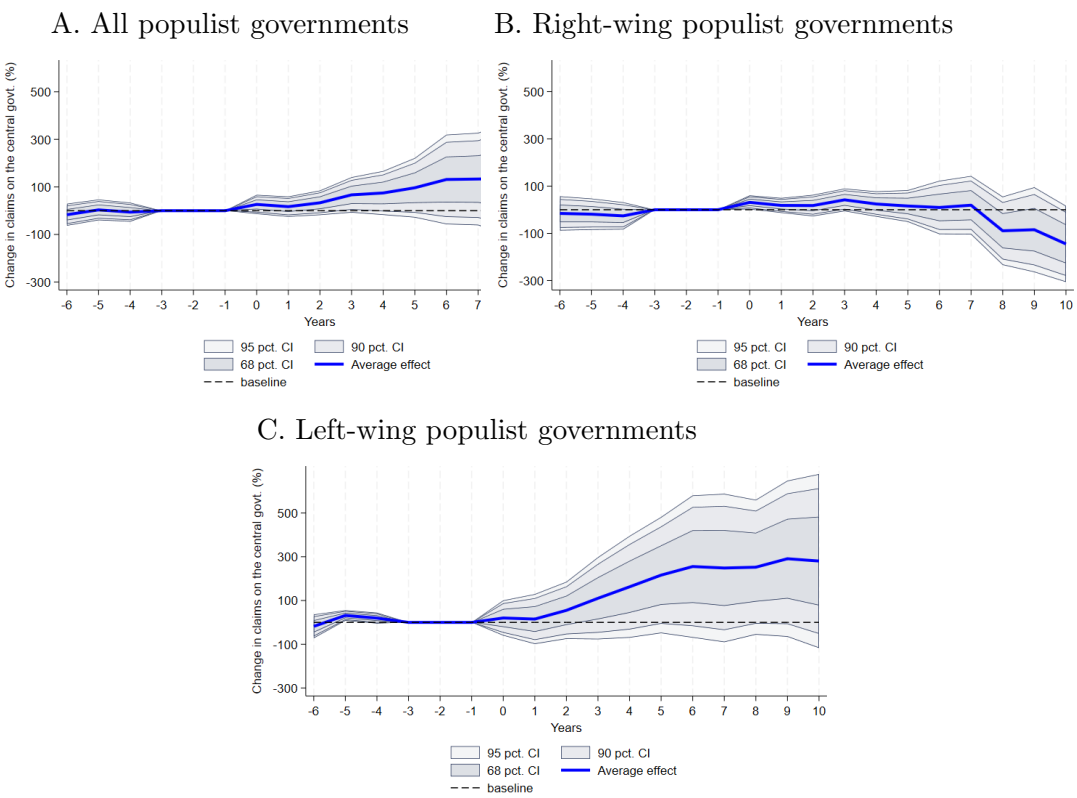
When considering all populist regimes, results point to a 150 percent cumulative increase in central bank credit 10 years after the populist government takes office (panel A). The estimated effect is significant at the 68 percent confidence level (one standard deviation) but not at the 90 percent level. The chart also highlights the absence of a pre-trend, suggesting that central bank credit does not follow an increasing or decreasing pattern prior to the populist regime taking office.

Next we distinguish between left- and right-leaning populist regimes, as classified in Funke et al. (2023). As documented in Magud and Spilimbergo (2021) and Funke et al. (2023), populist regimes tend to expand government expenditure, especially if one of their goals is to focus on domestic demand and redistributive policies, objectives that are plausibly attributed to left-leaning government. A key question is whether there is evidence that such efforts result in changes in central bank lending, or put differently, whether government expenditure is monetized. Panels B and C illustrate the markedly different path of central bank lending after the ascent of a right-wing and left-wing populist government, respectively. In the case of right-wing populist governments, our estimates point to moderate and insignificant growth on central bank credit in the early years, followed by a decline. By contrast, central bank credit grows substantially in the aftermath of left-wing populist governments taking office. Estimates point to a 300 percent cumulative growth in central bank credit 10 years after the populist government takes office, and results are statistically significant in the outer years of the horizon. In sum, results in Figure 2 point to medium-term expansion in central bank credit after the election of a populist government, especially when it is a left-leaning one.

We further illustrate the link between populist governments and central bank credit by focusing on episodes of abnormal growth in central bank credit. In particular, we identify years in which central bank credit's growth exceeds the country average plus two standard deviations. A similar methodology was used by Forbes and Warnock (2012) to identify sudden stops in capital flows. Having identified such episodes, we estimate the link between abnormal central bank credit growth and past exposure to populist regimes. In particular, we regress a dummy variable taking value one if a country experiences a year of abnormal central bank credit growth on the number of years the country has lived under a populist regime.

Results in Table 1, column (1), show that countries with higher past exposure to *any* populist regime are less likely to experience periods of abnormal central bank credit growth. However, as in Figure 2, there are marked differences when comparing exposure to left- and right-wing populist regimes. Higher exposure to right-wing populism is associated with a lower likelihood

Figure 2: Populism and Central Bank Credit



Notes: This figure plots the percent change increase in central bank claims on the central government h years after a populist regime enters office. Results follow the specifications in equations 2 and 3. Standard errors are calculated following the Driscoll-Kraay method. Shaded areas represent 68 percent (one standard deviation), 90 percent, and 95 percent confidence intervals

Table 1: Past Exposure to Populism and Episodes of Abnormal Central Credit Growth

Dep var.	Episodes of abnormal central bank credit growth				
	(1)	(2)	(3)	(4)	(5)
Years under populist government	-0.0039*				
	(0.0023)				
Years under right-wing populist government		-0.0134**	-0.0109**		
		(0.0050)	(0.0044)		
Years under left-wing populist government		0.0099*	0.0109**		
		(0.0055)	(0.0048)		
Growth of central bank credit to the central govt.			0.0794*		0.0793*
			(0.0451)		(0.0451)
Growth of central bank credit to the central govt. (t-1)			0.0151		0.0151
			(0.0118)		(0.0116)
Growth of central bank credit to the central govt. (t-2)			0.0023		0.0016
			(0.0146)		(0.0143)
Years under right-wing populist government (up to t-3)			-0.0136***	-0.0105**	
				(0.0048)	(0.0044)
Years under left-wing populist government (up to t-3)				0.0088*	0.0114**
				(0.0052)	(0.0051)
Left-wing populist govt. dummy				-0.0553	-0.0362
				(0.0516)	(0.0433)
Left-wing populist govt. dummy (t-1),				0.0722	0.0763
				(0.0649)	(0.0547)
Left-wing populist govt. dummy (t-2),				0.0020	-0.0388
				(0.0271)	(0.0277)
Right-wing populist govt. dummy				0.0609	0.0320
				(0.0990)	(0.0736)
Right-wing populist govt. dummy (t-1),				-0.0411	-0.0112
				(0.0716)	(0.0631)
Right-wing populist govt. dummy (t-2),				-0.0259	-0.0406
				(0.0283)	(0.0259)
Country FE	YES	YES	YES	YES	YES
Year FE	YES	YES	YES	YES	YES
Observations	1,970	1,970	1,970	1,970	1,970
R-squared	0.0012	0.0084	0.1313	0.0115	0.1332

Note: Driscoll-Kraay standard errors in parenthesis.
*** p<0.01, ** p<0.05, * p<0.1

of experiencing abnormally high central bank credit growth; by contrast, exposure to left-wing populism increases it (column 2). Our estimates suggest that an additional year of exposure to a left-wing populist regime increases the likelihood of a country experiencing an episode of abnormally central bank credit growth by about 1 percent, while an additional year of exposure to a right-wing populist regime decreases it by a commensurate amount. As shown in column 3, the results are robust to controlling for lagged central bank credit growth. If anything, the estimated impact of exposure to past left-wing populist regimes increases in magnitude. Next, we expand the analysis by separating past exposure to populism from recent populist governments. We do so by controlling for exposure to populism until $t-3$, and populism dummies in t, $t-1$ and $t-2$. Consistent with Figure 2, results in columns 4 and 5 show that episodes of abnormally high central bank credit growth are not necessarily linked to contemporaneous populist governments. By contrast, past exposure to left-wing populist regimes does increase the likelihood of abnormally high central bank credit growth.

So far we have documented the link between populist regimes and central bank credit to the

central government—or monetization of the government expenditure. A key question from the point of view of central banks is how central bank credit relates to inflation. Understanding this link is important not only from a contemporaneous perspective, as it highlights the importance of restricting central bank credit through legislation, but also from a longer-term perspective. Past episodes of deficit monetization associated with populist governments may shape the conduct of monetary policy. In particular, if the monetization of government expenditure resulted in higher inflation, central banks in countries that experienced such episodes may adopt a more aggressive monetary policy stance, consistent with evidence that past inflation influences the behavior of inflation-targeting central banks (Jácome et al., 2025b).

Figure 3 highlights the positive association between central bank credit to the central government and inflation. A one standard deviation increase in the central bank credit is associated with 3-4 percent cumulative increase in prices over a 10 year horizon relative to a country where CB credit remains constant (Panel A). The cumulative increase in prices is matched by a increase in inflation, which peaks after a year and remains significantly above pre-shock levels for 4-5 years. The increase in prices and in inflation is even more marked when considering high CB credit events. Prices experience a cumulative increase of close to 10 percent in the aftermath of a high CB credit event (panel C) and inflation jumps by around 4 percentage points. Compared to the one standard deviation shock, however, the effects of high CB credit episodes are short-lived—inflation falls below its pre-event level in the long term and prices return to its pre-shock level. Presumably, as described in Dornbusch and Edwards (1990b), as eventually a more orthodox government would take office with the aim of correcting the unsustainable policies.

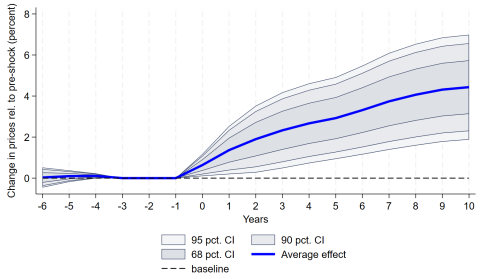
4.2 The Legacy of Populism and Fiscal Imbalances on Monetary Policy Rules

So far we have documented the link between populism, especially left-leaning populist regimes, central bank lending, and inflation. The analysis stresses how central bank lending, and, as a result, inflation, tend to increase in the aftermath of populist governments. Beyond the short- to medium-term implications of populist regimes Magud and Spilimbergo (2021), these types of governments can leave a large institutional and societal mark. On the one hand, countries that experience populist government tend to be more likely to elect these kind of governments in the future Funke et al. (2023). On the other hand, populist governments, especially those linked to economic mismanagement, can potentially trigger changes in institutional and behavioral attitudes both at a societal level and in the way policies are conducted. For example, as shown in Figure 4, when focusing on countries following IT regimes and zooming into the institutional design of central banks, we find that countries with no prior history of populist governments, have, on average, less independent central banks compared to those with a history of populist regimes (especially those with a history of both right- and left-wing populists).[16] Consistent with the previous section, countries with a history of left-wing populism also have, on average,

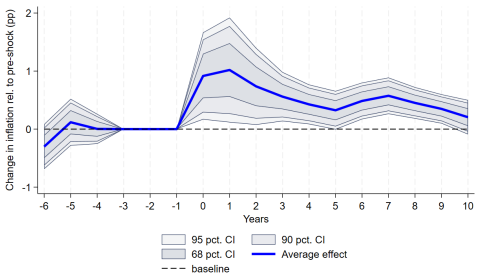
[16]In our sample, there is only one country with a history comprising of only right-wing populist governments. In that case, the CBIE lending index is zero.

Figure 3: Central Bank Credit and Inflation

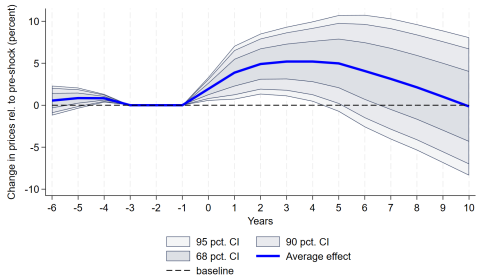
A. CB credit growth and cum.inflation



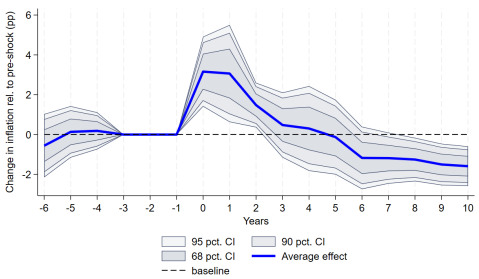
B. CB credit growth and inflation



C. High credit episodes and cum. infl.

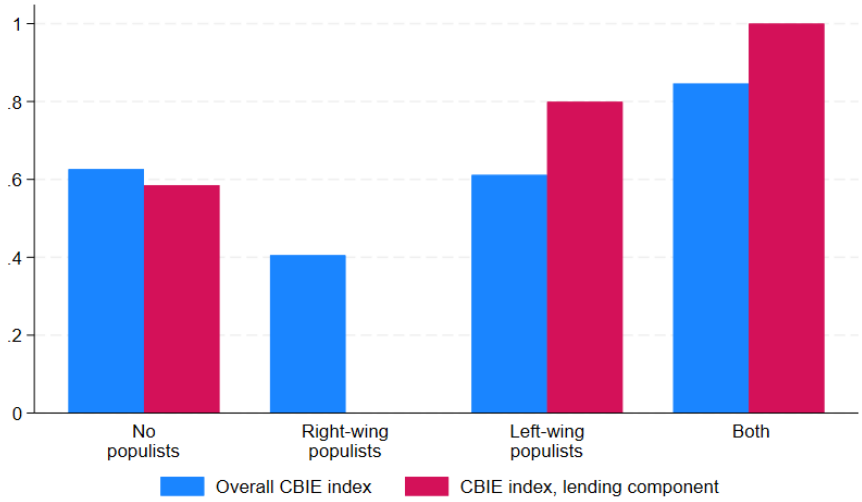


D. High credit episodes and inflation



Notes: This figure plots the relationship between central bank credit and inflation. Panels A and C plot the cumulative change in inflation over the projection horizon, that is the difference between lnp_{t+h} and lnp_{t-1}, while Panels B and D plot the change in the inflation rate, that is $\pi_{t+h} - \pi_{t-1}$. Panels A and B show the response to a 1 SD change in (log) central bank claims on the central governnment, while C and D show the response in the aftermath of a high CB credit growth episode. Results follow the specifications in equations 1. Standard errors are calculated following the Driscoll-Kraay method. Shaded areas represent one standard deviation (68 percent), 90 percent and 95 percent confidence intervals

Figure 4: Past Populism and Central Bank Independence in 2022



Notes: This figure plots the average value for the overall Central Bank Independence-Extended (CBIE) index proposed by Romelli (2022, 2024) and the central bank lending component. Averages are calculated for four groups of countries in our sample of IT central banks—those with no history of populist governments in the years preceding the establishment of the IT regime, those with a history of right-wing populist governments, those with a history of left-wing populist governments, and those with a history of both types of populist governments.

stronger limits to central bank lending to the government. Put differently, despite short- to medium-term weakening of institutions, eventually stronger institutions would be needed. In fact, such stronger institutions, are the response to the past effects of experiencing with populist governments. Thus, countries appear to eventually shape their institutions to prevent repeating some of the excesses of the past. This finding is also in line with Bocola et al. (2025), in market uncertainty about the commitment of a central banker to anchor inflation expectations results in weaker central bankers reacting more strongly than needed to inflationary shocks in order to signal their hawkishness.

But the legacy of past populism and fiscal imbalances can go beyond institutional design. It can also affect contemporaneous policy decisions. To explore the legacy of populism and fiscal imbalances on policy decisions, we focus on the conduct of monetary policy among central banks following an inflation targeting (IT) regime. Despite pursuing a similar policy objective—namely, price stability—and using a similar set of policy instruments—the policy rate—, differences in countries' initial conditions and histories may result in IT central banks responding differently to similar shocks. For example, Jácome et al. (2025b) show that countries with a history of high inflation prior to the adoption of the IT regime systematically respond more aggressively to deviation of inflation expectations from the central bank's target, a pattern that the authors coin "fear of past inflation." Such fear of past inflation may stem from different sources. First, central bankers' exposure to past inflation may make them more concerned about the de-anchoring of inflation expectations. Second, fear of past inflation may result from central bankers internalizing the fact that countries with a history of past inflation tend to have higher inflation expectations

(Salle et al., 2023) and countries where inflation concerns are prevalent, expectations respond more strongly to inflationary shocks (Magud and Pienknagura, 2025).

We expand the work of Jácome et al. (2025b) by allowing central banks' Taylor rules to be a function of the country's past exposure to populism and fiscal imbalances, as gauged by episodes of abnormal central bank lending. In particular, we estimate equation 5 and allow the coefficients for the inflation and output gap to be functions of a country's past history.

Results in Table 2 highlight the relevance of a country's past history in shaping the conduct of monetary policy. Column (1) presents Taylor rule estimates for the average country in our sample. Consistent with Jácome et al. (2025b), we find that the coefficient for the expected inflation gap is both statistically and economically significant: a one percent deviation of expected inflation from the target triggers, on average, a change in the policy interest rate of around 20-22 basis points. Policy rates also react to the output gap, albeit not as strongly.

Next we turn to studying how the response of policy rates to changes in the inflation and output gaps vary depending on a country's past exposure to populism and to episodes of abnormal central bank lending. Column 2 showcases how countries that experienced episodes of abnormal central bank lending prior to the adoption of an IT regime react more strongly to the expected inflation gap. On average, a country with a history of high central bank lending has an inflation gap coefficient that is roughly twice as large compared to a country with no prior history of abnormal central bank credit. By contrast, the difference in the output gap coefficient between these two groups of countries is small and statistically insignificant. Note that, as discussed in the previous section, countries that experienced abnormal central bank lending are also likely to have experienced high levels of inflation. To tease out these two exposures—high inflation and abnormal central bank lending—column 3 also includes an interaction between the country's average pre-IT inflation and the expected inflation and output gaps. Results suggest that both a history of high inflation and of fiscal monetization drive the central bank's monetary policy response. In both cases, the central bank responds more aggressively to deviations of expectations from the target compared to countries that had low inflation or do not have a history of monetization. This suggests that, in addition to the insights detailed in Jácome et al. (2025b) about how a history of high inflation can make central banks more responsive to the inflation gap, high levels of central bank lending in the past may prompt the central bank to act aggressively today in order to signal a clear break from the country's history of fiscal dominance.

Table 2: The Role of Past Exposure to Populism and Abnormal Central Bank Lending on Monetary Policy

Dep. var.	Policy Rate						
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
Policy rate (t-1)	0.8723***	0.8604***	0.8573***	0.8634***	0.8616***	0.8591***	0.8581***
	(0.0323)	(0.0313)	(0.0313)	(0.0307)	(0.0306)	(0.0303)	(0.0304)
XR depreciation	-0.0196*	-0.0194*	-0.0198*	-0.0183*	-0.0187*	-0.0185*	-0.0189*
	(0.0110)	(0.0110)	(0.0110)	(0.0110)	(0.0110)	(0.0111)	(0.0111)
XR depreciation (t-1)	0.0203**	0.0198**	0.0204**	0.0191*	0.0197**	0.0193*	0.0199*
	(0.0100)	(0.0100)	(0.0099)	(0.0100)	(0.0100)	(0.0101)	(0.0101)
US Pol. rate (t-1)	0.0748***	0.0893***	0.0994***	0.0943***	0.1006***	0.0980***	0.1035***
	(0.0269)	(0.0265)	(0.0283)	(0.0279)	(0.0286)	(0.0275)	(0.0284)
Output gap	0.0687***	0.0634***	0.0550***	0.0589***	0.0538***	0.0582***	0.0527***
	(0.0151)	(0.0157)	(0.0153)	(0.0125)	(0.0147)	(0.0145)	(0.0154)
Inflation gap (expected inf)	0.2207***	0.1981**	0.0917	0.2023***	0.1304*	0.1949**	0.1363*
	(0.0714)	(0.0790)	(0.0729)	(0.0726)	(0.0750)	(0.0780)	(0.0720)
Inf. gap x Past central bank lending dummy		0.1444**	0.1179*			0.0775	0.0710
		(0.0676)	(0.0664)			(0.0607)	(0.0612)
Output gap x Past central bank lending dummy		0.0003	-0.0046			-0.0015	-0.0036
		(0.0064)	(0.0074)			(0.0086)	(0.0087)
Inf. gap x Pre-IT inflation			0.4048**		0.2724**		0.2237*
			(0.1900)		(0.1349)		(0.1303)
Output gap x Pre-IT inflation			0.0478		0.0298		0.0367
			(0.0306)		(0.0342)		(0.0330)
Inf. gap x Past right-wing populist				0.0322	0.0357	0.0072	0.0119
				(0.0232)	(0.0244)	(0.0202)	(0.0207)
Output gap x Past right-wing populist				0.0005	-0.0024	0.0011	-0.0015
				(0.0043)	(0.0061)	(0.0056)	(0.0070)
Inf. gap x Past left-wing populism				0.0288***	0.0245***	0.0225***	0.0194***
				(0.0096)	(0.0086)	(0.0072)	(0.0066)
Output gap x Past left-wing populism				0.0009	0.0005	0.0011	0.0007
				(0.0015)	(0.0016)	(0.0017)	(0.0017)
Observations	2,617	2,617	2,513	2,617	2,513	2,617	2,513
Number of groups	32	32	31	32	31	32	31
Adjusted R-squared	0.900	0.903	0.901	0.904	0.902	0.905	0.902

Note: This table reflects equations 4-5 The inflation gap is computed using inflation expectations. All specifications control for country fixed effects. Driscoll-Kraay standard errors in parenthesis.
*** p<0.01, ** p<0.05, * p<0.1

Motivated by the link between populism and central bank credit illustrated in section 4.1, column 4 shoes results for a version of equation 5 where the inflation and output gaps are interacted with the number of years under a right-wing and left-wing populist regime that a country experienced up to 10 years before the adoption of the IT regime. Consistent with our findings in section 4.1, we find that while the coefficients for the interaction between the inflation gap and the count of years under a right-wing and left-wing populist regime, respectively, are positive and similar in magnitude, the former is not statistically significant. The estimated coefficients also imply an economically meaningful effect of past exposure to left-wing populist governments—a country with 3.13 years of left-wing populist exposure, the average in our sample of IT countries, has a coefficient that is 30 percent higher than a country with no left-wing populist exposure. In the case of the coefficient for the interaction of the populist exposure variables and the output gap, neither is statistically significant.

Next we consider the links between past populism exposure, a history of abnormally high central bank credit, and past inflation affect our results in columns (2)-(4). First, as we did for the dummy capturing past episodes of high central bank lending, in column (5) we include both the interaction of the inflation and output gap with the populism exposure, and the interaction of the inflation and output gap with the average historical inflation. As in column (3), we find that both the the interaction of the inflation gap with the average past inflation and with exposure to left wing populism are positive and statistically significant, while other interactions are not statistically significant. Similar to column (3), we interpret this as reflecting two distinct ways in which history may affect monetary policy—one is by potentially affecting expectation formation (as captured by the positive interaction between the inflation gap and average past inflation) and another is by making central banks more inclined to show independence, to break from past influence (Jácome et al., 2025b and Bocola et al., 2025). Indeed, column 6 points in a similar direction. When we include both the interaction of the gaps with populism exposure and the interactions of the gaps with a country's exposure to past central bank lending, the coefficient of the latter loses statistical significance, suggesting that they affect monetary policy through similar channels. This confirmed in column 7, where we include the three sets of interactions (gaps, on the one hand, and exposure to left-wing populism, to high central bank lending, and to high inflation, on the other), and only those with exposure to populism and high past inflation remain statistically significant.

4.3 Robustness Exercises

This section explores the robustness of our main result—i.e., that countries that experienced left-wing populist regimes and episodes with high levels of central bank lending to the central government— react more strongly to the expected inflation gap relative to those that did not. More broadly, it also tests alternative specifications for the Taylor rule.

Note that a history of populist regimes may affect structural variables that are important for the effectiveness and conduct of monetary policy. For example, exposure to populism may affect the development of domestic financial markets, if these governments introduce distortions

to domestic credit to achieve their economic and social goals. Similarly, populist regimes have a tendency to close the economy to trade and capital flows Funke et al. (2023). Deep financial markets make the transmission of monetary policy more effective, as changes in the central bank's policy rate have a strong effect on long-run interest rates in the financial system—thus having a greater impact on consumption and investment and, hence, on inflation and output. In contrast, shallow financial markets tend to impair the transmission mechanism of monetary policy, weakening its impact on inflation. Advanced economies also enjoy fully open capital accounts. While cross-border capital flows could, in principle, create exchange rate volatility, its impact is attenuated when financial systems are well developed and, thus, a well-functioning market of derivatives is in place that allows market participants to hedge against large foreign currency volatility. To the extent that emerging market economies do not have a deep market of derivatives, large changes in capital inflows and outflows induce foreign exchange volatility and, depending on the central bank credibility, large exchange rate depreciations can have an adverse effect on inflation.

In addition, an important characteristic of emerging markets and developing countries with IT regimes is that several of them are large net commodity exporters. This can affect both the likelihood of having experienced populist governments (Magud and Spilimbergo, 2021), and the conduct of monetary policy. Indeed, being a net commodity exporter may condition monetary policy decisions because recurrent terms of trade shocks have an impact on output, the exchange rate and, sometimes inflation—although the latter hinges on the exchange rate pass-through that, in turn, depends on the credibility of the central bank (Carrière-Swallow et al., 2021)—, especially if the shock is of considerable scale and duration. Thus, the need for inflation targeting countries to have flexible exchange rate regimes. Moreover, central banks in commodity exporting countries could even face non-trivial policy trade-offs when confronting simultaneously an adverse terms of trade shock and tightening monetary conditions in the U.S. The former inflicts a negative effect on output and, hence, suggests loosening monetary policy, whereas the latter advice implementing a tightening stance to tackle capital outflows and exchange rate depreciation, which may have an impact on inflation expectations.

Finally, central bank independence and transparency are fundamental pillars of inflation targeting. Yet central bank independence and transparency vary across countries, and these difference may be associated with past exposure to populism. Specifically, central banks in emerging markets are more independent but less transparent than in advanced economies. Central banks are probably more independent because of their previous history of high inflation, which was often associated to the governments' use of central banks to finance their coffers and to serve their short-term political agenda, in particular during electoral cycles.[17]

[17]The heterogeneity of countries following an IT regime is highlighted in Jácome et al. (2025a) Additional details about the institutional arrangement of different inflation targeting countries are presented in Appendix Jácome et al. (2025a), which updates the description in Hammnond (2012).

Table 3: The Role of Past Exposure to Populism and Abnormal Central Bank Lending on Monetary Policy—Additional Controls

Dep. var.	Policy Rate					
	(1)	(2)	(3)	(4)	(5)	(6)
Policy rate (t-1)	0.8562***	0.8540***	0.8624***	0.8599***	0.8557***	0.8545***
	(0.0316)	(0.0311)	(0.0311)	(0.0306)	(0.0307)	(0.0306)
XR depreciation	-0.0188*	-0.0191*	-0.0178	-0.0183	-0.0182	-0.0185*
	(0.0111)	(0.0112)	(0.0110)	(0.0112)	(0.0110)	(0.0111)
XR depreciation (t-1)	0.0185*	0.0188*	0.0184*	0.0188*	0.0182*	0.0186*
	(0.0097)	(0.0097)	(0.0099)	(0.0098)	(0.0097)	(0.0097)
Output gap	0.0506***	0.0380**	0.0317*	0.0272	0.0501***	0.0364**
	(0.0137)	(0.0151)	(0.0173)	(0.0178)	(0.0150)	(0.0156)
Inflation gap (expected inf)	0.1928*	-0.0220	0.1896*	-0.0045	0.2146**	0.0715
	(0.1074)	(0.1606)	(0.1059)	(0.1811)	(0.1049)	(0.1558)
Inf. gap x Past central bank lending dummy	0.1511*	0.1232*			0.1581**	0.1402*
	(0.0804)	(0.0722)			(0.0793)	(0.0736)
Output gap x Past central bank lending dummy	-0.0336*	-0.0353*			-0.0367*	-0.0389*
	(0.0196)	(0.0201)			(0.0204)	(0.0210)
Inf. gap x Pre-IT inflation		0.6017***		0.5324**		0.3939**
		(0.2229)		(0.2467)		(0.1987)
Output gap x Pre-IT inflation		0.0417		0.0208		0.0452
		(0.0295)		(0.0319)		(0.0337)
Inf. gap x Past right-wing populist			0.0037	0.0032	-0.0484	-0.0432
			(0.0203)	(0.0192)	(0.0352)	(0.0324)
Output gap x Past right-wing populist			-0.0016	-0.0037	0.0098	0.0080
			(0.0069)	(0.0081)	(0.0062)	(0.0076)
Inf. gap x Past left-wing populism			0.0271***	0.0200***	0.0241***	0.0192***
			(0.0072)	(0.0056)	(0.0062)	(0.0053)
Output gap x Past left-wing populism			-0.0014	-0.0018	-0.0011	-0.0017
			(0.0012)	(0.0012)	(0.0012)	(0.0012)
Observations	2,617	2,513	2,617	2,513	2,617	2,513
Number of groups	32	31	32	31	32	31
Adjusted R-squared	0.905	0.904	0.905	0.904	0.907	0.905

Note: The inflation gap is computed using inflation expectations. All specifications control for country fixed effects and interactions of the output and inflation gaps with the level of financial development, capital account openness, trade as share of GDP, and central bank independence at the time of IT adoption, as well as interactions with a commodity exporter dummy. Driscoll-Kraay standard errors in parenthesis.
*** p<0.01, ** p<0.05, * p<0.1

To further study the link between, we extend the Taylor rule specification in Table 2 to include interactions between the output and inflation gaps and the level of financial development, capital account openness, trade as share of GDP, and central bank independence at the time of IT adoption, as well as interactions with a commodity exporter dummy.[18] Results in Table 3 shows that, as was the case in Table 2, a history of past exposure to high levels of central bank lending amplifies the central bank's response to the inflation gap (column 1). This is also true when we control for the interactions with average past inflation. The inclusion of the additional controls, however, changes the sign and significance of the coefficient for the interaction between the output gap and the dummy capturing a history of high central bank lending. In this case, the central bank is less responsive to the output gap when the country has a history of monetization, all else equal. This is consistent with the view that central banks in countries with past fiscal dominance put extra emphasis on inflation, at the expense of activity, to strengthen its credibility. As before, this interpretation is confirmed when we control for the interactions of the gaps with the country's exposure to populist regimes, as central banks in countries with a history of left-leaning populist governments tend to respond more strongly to the inflation gap compared to other countries. These findings are robust to other configurations of the interaction terms.

We also test for the robustness of our results to the inclusion of time fixed effects and fixed effects controlling for the number of years since the adoption of inflation targeting. Table 4, columns 1-3 replace the US policy rate with time fixed effects controlling not for the global financial cycle but also for other global variables such as global GDP. Results from this more flexible specification paint a similar picture as those in Table 3 with relevant coefficients remaining virtually unchanged. Next, columns 4-6 control for both time fixed effects and fixed effects for years as an IT central bank. This takes into account the fact that, as discussed in Jácome et al. (2025a), a central bank's IT regime may become more credible as time passes, thus affecting its monetary policy response. Results show that results remain virtually unchanged once we control for both sets of fixed effects.

5 Conclusion

Amid a new wave of populist governments taking office in recent years, understanding the macroeconomic implications of such governments is key. This paper revisits the historical links between populism and central bank lending to the central government, or deficit monetization. This kind of deficit financing was popular among populist regimes in the past, especially left-wing populist regimes, and entails the central bank and monetary policy being overtaken by fiscal objectives. We show that central bank lending increases substantially in the aftermath of a left-wing populist being elected. At the same time, central bank lending to the central government is associated with higher inflation.

Importantly, the impacts of populist regimes can outlive the regime's lifespan. In fact,

[18] For brevity, other interactions are not included in the table.

they can cast a long shadow over the country's policy making. We document how countries with a history populist regimes have today legislation granting high levels of independence to central banks, especially when it pertains to central bank lending to the central government. Moreover, our econometric evidence shows how in countries with a populist past, and a history of deficit monetization, central banks following an inflation targeting regime respond more strongly to the inflation expectation gap—i.e., deviations of expectations from the target—compared to countries with populist history. We show that this not fully explained by the country's inflationary history, and could be interpreted as a sign that the central bank has to make extra efforts to signal its independence from the central government.

Going forward, it is important to recognize that the hard-earned independence of central bank in many countries with a populist past cannot be taken for granted. As documented in Jácome and Pienknagura (2026), central banks in Latin America where created as institutions with a high degree of independence, which was gradually lost in the aftermath of great depression and the ascent of populist regimes. Today we see renewed pressures from some governments for central banks to accommodate the central government's objectives (Binder, 2021). Thus, shielding monetary authorities from political influence and reaffirming their mandate is critical, not only to fight the fully contain the recent inflationary bout, which has reached record highs in more than 20 years, but also to secure price stability in the medium term.

Table 4: The Role of Past Exposure to Populism and Abnormal Central Bank Lending on Monetary Policy—Additional Controls and Time Fixed Effects

Dep. var.	Policy Rate					
	(1)	(2)	(3)	(4)	(5)	(6)
Policy rate (t-1)	0.8475***	0.8561***	0.8494***	0.8479***	0.8572***	0.8500***
	(0.0391)	(0.0385)	(0.0384)	(0.0403)	(0.0397)	(0.0399)
XR depreciation	-0.0272**	-0.0263**	-0.0267**	-0.0283***	-0.0271**	-0.0275**
	(0.0107)	(0.0109)	(0.0106)	(0.0107)	(0.0110)	(0.0107)
XR depreciation (t-1)	0.0195*	0.0191*	0.0195*	0.0203*	0.0197*	0.0201*
	(0.0106)	(0.0107)	(0.0106)	(0.0106)	(0.0105)	(0.0105)
Output gap	0.0595***	0.0460**	0.0532***	0.0651***	0.0538***	0.0600***
	(0.0173)	(0.0200)	(0.0182)	(0.0173)	(0.0194)	(0.0181)
Inflation gap (expected inf)	-0.0482	-0.0251	0.0488	-0.0423	-0.0285	0.0476
	(0.1729)	(0.1888)	(0.1661)	(0.1618)	(0.1791)	(0.1553)
Inf. gap x Pre-IT inflation	0.6284**	0.5294**	0.4051*	0.6156**	0.5255**	0.4025*
	(0.2522)	(0.2582)	(0.2183)	(0.2475)	(0.2500)	(0.2117)
Output gap x Pre-IT inflation	0.0417	0.0306	0.0521*	0.0431	0.0301	0.0530*
	(0.0279)	(0.0287)	(0.0301)	(0.0279)	(0.0289)	(0.0306)
Inf. gap x Past central bank lending dummy	0.1272*		0.1426**	0.1316*		0.1425**
	(0.0683)		(0.0669)	(0.0715)		(0.0688)
Output gap x Past central bank lending dummy	-0.0332*		-0.0330*	-0.0336*		-0.0333*
	(0.0181)		(0.0187)	(0.0176)		(0.0181)
Inf. gap x Past right-wing populist		-0.0011	-0.0492*		0.0110	-0.0356
		(0.0178)	(0.0277)		(0.0223)	(0.0291)
Output gap x Past right-wing populist		-0.0111	-0.0007		-0.0115	-0.0016
		(0.0083)	(0.0069)		(0.0079)	(0.0062)
Inf. gap x Past left-wing populism		0.0222***	0.0207***		0.0223***	0.0210***
		(0.0057)	(0.0050)		(0.0056)	(0.0053)
Output gap x Past left-wing populism		-0.0015	-0.0014		-0.0015	-0.0015
		(0.0012)	(0.0012)		(0.0013)	(0.0013)
Time FE	YES	YES	YES	YES	YES	YES
Years as IT Control	NO	NO	NO	YES	YES	YES
Observations	2,513	2,513	2,513	2,513	2,513	2,513
Number of groups	31	31	31	31	31	31
Adjusted R-squared	0.915	0.915	0.917	0.918	0.917	0.919

Note: The inflation gap is computed using inflation expectations. All specifications control for country fixed effects and interactions of the output and inflation gaps with the level of financial development, capital account openness, trade as share of GDP, and central bank independence at the time of IT adoption, as well as interactions with a commodity exporter dummy. Driscoll-Kraay standard errors in parenthesis.
*** p<0.01, ** p<0.05, * p<0.1

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