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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.

JEL codes: E43, E52, E58

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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, and more recently the war in the Middle East. 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 issues, this paper focuses on two interrelated questions: (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 50 countries from Funke et al. (2023) with data annual 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. In a separate exercise, we also include quarterly data on policy rates, inflation expectations, inflation targets, economic activity, and exchange rates for 32 inflation targeting countries for the period since each country adopted an IT regime until 2023.

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).

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

[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 known about the ways in which these forces interact and what could its potential legacy be.

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 pursue expansive policies, especially if one of their goals is to focus on domestic demand and redistributive objectives, the latter 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.

Next, we develop a more novel contribution. 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. Specifically, beyond short-term effects, exposure to populism and deficit monetization can affect monetary policy in the medium- to long-term, as posed in our second question. 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) currently 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 de-anchoring. 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, needing to send stronger signals of their independence and commitment to price stability to effectively being able to anchor inflation expectations and contain inflationary pressures. Additionally, when we split populists between right-wing and left-wing, we find an economically meaningful effect of past exposure to left-wing populist governments, but not to right-wing ones. Consistent with the interpretation that central banks with a populist past need to respond more forcefully when inflation expectations appear less firmly anchored, in a restricted sample for which measures of inflation forecast dispersion are available, we find that the differential response of central banks with a populist past is larger when disagreement about future inflation is high.

To illustrate the historical mechanisms underlying our empirical results, Annex A examines the experiences of Argentina, Chile, and Mexico. These cases show how populist or populist-style governments used central bank financing to support expansionary fiscal programs, weakening monetary-policy independence and fueling inflation. In Argentina, beginning with the erosion of central bank independence under Peronism in the mid-1940s and continuing through later episodes of fiscal dominance, governments repeatedly relied on central bank credit, transitory advances, and transfers of realized and unrealized profits to finance fiscal imbalances, contributing to recurrent inflationary surges.[2] In Chile, the Allende government combined expansionary fiscal policy, price controls, and direct control over monetary policy, producing a sharp increase in central bank credit and inflation before subsequent reforms restored monetary discipline. In Mexico, the populist macroeconomic cycle under Echeverría and López Portillo in the 1970s relied on public investment, social spending, external borrowing, and central bank financing, culminating in high inflation and the 1982 currency, banking, and sovereign-debt crisis. Together, the three episodes provide historical motivation for our empirical focus on deficit monetization as the channel linking populism to inflation and, ultimately, to the conduct of monetary policy under inflation targeting.

Literature Review. This paper contributes to several strands of the literature. First, it contributes to a large literature on inflation targeting. Ball (2010), Svensson (2010), and Walsh (2010) summarize three important results from these studies: (i) inflation targeting,

[2]Argentina is a country that features an unparalleled history of populism, mostly with a left-wing political orientation and some right-wing populists too. Left-wing populist governments typically spent beyond what they collected in taxes, and often failed to consolidate debt obligations from provinces, which eventually exacerbated fiscal deficits, even during the right-wing populist period as Dominguez and Tesar (2007) highlight. To finance the resulting fiscal imbalances, the central bank granted the government transitory advances at subsidized interest rates, paid on behalf of the government foreign exchange obligations with multilateral institutions and private creditors, and made advance transfers to the government of both realized and non-realized profits.

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;[3] (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 unconventional monetary policies, but re-emerged after the surge in 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.

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 are 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,

[3]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.

and Giuliano and Spilimbergo (2023, 2024) 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.[4] 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 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 a simple illustrative model with the only purpose of providing a conceptual framework to the paper's contribution, which is empirical. Section 3 describes the empirical specification used to conduct the analysis and the data feeding the study, while Section 4 discusses the main results. Section 5 distills the main conclusions of the paper. An appendix describes some individual case studies related to the findings of the paper.

[4] 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.

2 A Simple Model of High Inflation and Populist History and Monetary Policy

Before turning to presenting the results of our econometric estimation, which are the contribution of the paper, to fix ideas, this section presents a simple New-Keynesian (NK) model that incorporates experienced learning (the legacy of populism and inflation). It builds on the model presented in Jácome et al. (2025a,b). A young but growing empirical literature documents that past episodes of high inflation significantly affect current inflation expectations. This phenomenon is known as experienced learning. The model in this section explores the implications of incorporating experienced learning, both in terms of past high inflation and also of fiscal dominance and populism as the drivers of past high inflation, in an otherwise standard NK model. First, the section characterizes the equilibrium under inflation targeting when the experienced learning channel is turned off. Then it shows how experienced learning affects the equilibrium dynamics under inflation targeting, and how this affects the costs of economic stabilization.

2.1 The Rational Expectations Benchmark

Consider a three-equation linear new-Keynesian model. The Euler equation is of the form:

$$y_t = E_t y_{t+1} - \frac{1}{\sigma}(i_t - E_t \pi_{t+1}) \tag{1}$$

where π_t is the deviation of inflation from the intended target, implicitly assumed to be driven by fiscal dominant populist leaders' policies, y_t is the output gap, i_t is the nominal interest rate expressed in deviation from its steady-state level, and E_t is the expectation operator conditional on relevant information in period t (which will depend on the expectation model being considered). The intertemporal elasticity of consumption substitution is represented by $1/\sigma$, where the parameter σ is assumed to be positive. The Euler equation, thus, states that expected output growth is increasing in the expected real interest rate.

The Phillips curve takes the form:

$$\pi_t = \beta E_t \pi_{t+1} + \kappa y_t \tag{2}$$

where $\beta \in (0, 1)$ is the subjective discount factor and $\kappa > 0$ is a parameter that is decreasing in the degree of price stickiness. The fact that in the Phillips curve current inflation depends not only on the current output gap but also on people's expectations about future inflation will play a central role in determining the cost of inflation stabilization under alternative assumptions about how expectations are formed.

Assume that the central bank implements strict inflation targeting, so that:

$$\pi_t = 0 \tag{3}$$

for all $t \geq 0$. We assume that the central bank can commit to maintaining this policy over time. The question we tackle is how costly it is to implement this policy in terms of the output gap y_t and what does it imply for the level of the policy rate i_t.

Our simple three-equation framework suggests that under rational expectations, the fact that $\pi_t = 0$ for all t implies that the conditional expectation of inflation, $E_t\pi_{t+1}$, must also be zero. Plugging $E_t\pi_{t+1} = 0$ in the Phillips curve (2) yields:

$$y_t = 0 \tag{4}$$

for all t. Thus, under rational expectations it is costless to fully stabilize inflation, the well-known result sometimes referred to as the "divine coincidence:" in the absence of cost-push shocks, the rational expectations solution of the new-Keynesian model implies that inflation stabilization goes in tandem with output stabilization.

Consider now the equilibrium path of the nominal interest rate that supports this outcome. Using $y_t = E_t y_{t+1} = E_t\pi_{t+1} = 0$, we can solve the Euler equation (1) for the equilibrium interest rate, to get:

$$i_t = 0 \tag{5}$$

for all t, which says that to achieve price and output stability, the government does not need to deviate the policy rate from its steady-state value (typically referred to as the natural or neutral interest rate). In other words, macroeconomic stabilization is not associated with a particularly dovish or hawkish monetary policy. As we will see next, this will cease to be the case under experience learning.

2.2 Stabilization Under Experienced Learning

To model experienced learning, we assume that if the economy suffered high inflation and/or fiscal populism in the past, then inflationary expectations evolve over time according to the expression:

$$E_t\pi_{t+1} = \lambda^t \pi^H + \lambda^{t-\tau} P \tag{6}$$

Here, the inflationary episode, denoted $\pi^H > 0$, occurs in period 0, and the parameter $\lambda \in (0, 1)$ denotes the rate of decay of the inflationary memory. Similarly, the latest populist episode

(P) occurs in period τ, and we assume that the rate of decay of the populist memory is the same as that of high inflation. The formulation with memory depreciation is in line with empirical studies that document "recency bias" in experience learning (Malmendier and Nagel, 2011; Magud and Pienknagura, 2025). Note that the formulation allows for the possibility that populist regimes affect expectations not only through their potential effects on high inflation (for example, driven by monetary financing of unsustainable fiscal policies), but also because they might weaken institutional frameworks, which could affect the formation of inflation expectations.

Let's now address the same question we answered in the economy with rational expectations, namely, how costly is it to stabilize the rate of inflation and what is the path of the policy rate consistent with this goal. Using $\pi_t = 0$ and $E_t\pi_{t+1} = \lambda^t\pi^H + \gamma^{t-\tau}P$ and plugging them to the Phillips curve (2), we see immediately that:

$$y_t = -\frac{\beta\lambda^t(\pi^H + \lambda^{-\tau}P)}{\kappa} \tag{7}$$

This expression reveals that experienced learning imposes costs on inflation stabilization. Specifically, the output gap becomes negative for as long as the memory of either a bad inflationary episode, especially if driven by unsustainable fiscal policies, or of a populist regime itself persist. The intuition behind this result is straightforward. In the New Keynesian framework, the current deviation of inflation from target equals the present discounted value of current and future marginal costs. If a prior inflationary experience or a populist regime that weakened institutions leads people to believe that marginal costs will remain high in the future, the central bank must preemptively cool the economy to prevent inflation in the present. This requires inducing a negative output gap. The cost in terms of lost output depends on several factors: (a) the severity of the past inflationary exposure (π^H), with larger exposure amplifying the cost; (b) the recency of the exposure to inflation (smaller t) or populism ($t - \tau$), as more recent episodes weigh more heavily on expectations; (c) the persistence of the memory of the exposure (larger λ), which prolongs the economic effects of a history of high inflation and/or populism; (d) the degree of price stickiness (smaller κ), with stickier prices exacerbating the output loss; and (e) the subjective discount factor: Even though experienced learning looks back in time (that is, it is backward-looking), the magnitude of the cost of inflation stabilization depends not only on the rate at which people discount the past, λ, but also on the rate at which people discount the future, β. This is because the former determines the expected size of marginal costs in the future, while the latter determines their present value. Thus, both backward- and forward-looking issues are relevant in equilibrium.

How does experienced learning affect monetary policy? To calculate the path of the nominal interest rate, i_t, consistent with strict inflation targeting, substitute in the Euler equation (1) the values of y_t, $E_t y_{t+1}$, and $E_t\pi_{t+1}$ implied by equations (6) and (7). This gives:

$$i_t = [\ 1 + \frac{\beta\sigma}{\kappa}(1-\lambda)]\ (\lambda^t \pi^H + \lambda^{t-\tau} P) > 0 \tag{8}$$

The nominal interest rate is above its steady-state level throughout the transition. Thus, under experience learning, inflation stabilization requires a more hawkish monetary policy stance relative to rational expectations if inflation is to be stabilized. The required tightening is more severe the larger the inflation exposure, π^H, when there was a populist regime, the stickier prices are (the smaller κ is), and the more risk averse agents are (the higher σ is).

In other words, the issue arises when agents may have doubts in regard to the ability of an inflation targeting central bank to achieve its inflation goal, that is, when inflation expectations are not perfectly anchored and the central bank is committed to achieve inflation stabilization. This drives the central bank to be willing to pay the real cost (in terms of a recession) needed to keep inflation at its desired level. These dynamics highlight the role of path dependence and the importance of central bank credibility in the response of the central banks to deviations of expected inflation from target.

Having the above model only as a conceptual framework, the rest of the paper studies empirically the link between populism, fiscal monetization and inflation, and the relationship between past populism episodes and the conduct of monetary policy. In particular, it focuses on studying how past episodes of populism affects the central bank's response to inflation. In line with the simple model, results point to central banks in countries with a history of either high inflation or past populism being more responsive to inflation deviations (more hawkish).

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 exploit cross-country heterogeneity with respect to past inflationary and populist history among countries with an inflation targeting regime.

3.1 Econometric Specification

The paper's analysis is split into two distinct set of exercises. The first set 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). We use data for 47 countries for the period 1960-2008; we end in 2008 because thereafter the central-bank-claims series, which is central to the analysis, undergoes definitional changes that make the pre- and post-2008 sub-samples difficult to compare. In particular, we first estimate a regression exploring the link between central bank

lending and inflation, as follows:

$$\Delta p_{c,t+h,t-1} = \alpha_c + \tau_t + \beta CBL_{c,t} + \sum_{j=1}^{3}(\gamma \pi_{c,t-j} + \omega CBL_{c,t-j} + \rho PB_{c,t-j}) + \varepsilon_{c,t} \tag{9}$$

where $\Delta p_{c,t+h,t-1} = p_{c,t+h} - p_{c,t-1}$ is the log difference of the price levels between periods $t+h$ and $t-1$, CBL is the growth of central bank claims to the central government,[5] π is the inflation rate, and α, τ are country and time fixed effects, respectively. 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 comparing the 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).[6] With that sample, we estimate two specifications. The first treats all populist governments equally, as follows:

$$CBL_{c,t+h,t-1} = \alpha_c + \tau_t + \beta POP_{c,t} + \sum_{j=1}^{3}(\gamma_j \pi_{c,t-j} + \omega_j CBL_{c,t-j,t-j-1} + \rho PB_{c,t-j}) + \varepsilon_{c,t} \tag{10}$$

where, as mentioned above, $CBL_{c,t+h,t-1}$ 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 10 by differentiating between left-leaning populist regimes and right-leaning ones. In particular, we estimate:

$$\begin{aligned} CBL_{c,t+h,t-1} = \alpha_c + \tau_t + \beta_L LPOP_{c,t} + \beta_R RPOP_{c,t} + \\ \sum_{j=1}^{3}(\gamma_j \pi_{c,t-j} + \omega_j CBL_{c,t-j,t-j-1} + \rho PB_{c,t-j}) + \varepsilon_{c,t} \end{aligned} \tag{11}$$

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-

[5] 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.

[6] The formal definitions of clean control and clean treatment we employ are as follows: Let $P_{c,t}$ be an indicator variable taking the value one if country c is under a populist regime in period t, and zero otherwise. Let $POP_{c,t}$ be an indicator variable taking the value one if country c enters a populist regime in period t, that is, if $P_{c,t-1} = 0$ and $P_{c,t} = 1$, and zero otherwise. For a given horizon h, an observation with $POP_{c,t} = 0$ is a clean control if $P_{c,s} = 0$ for all $s = t-5, \ldots, t+h$. An observation with $POP_{c,t} = 1$ is a clean treatment if $P_{c,s} = 0$ for all $s = t-5, \ldots, t-1$ and $POP_{c,s} = 0$ for all $s = t+1, \ldots, t+h$.

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 for a sample of 32 countries from the first year each country adopts an IT regime until 2023. The baseline specification takes the following form:

$$\begin{aligned} i_{c,t} = \alpha_c + \rho i_{c,t-1} + \beta \pi gap_{c,t} + \gamma Ygap_{c,t} + \\ \theta \Delta NEER_{c,t} + \mu \Delta NEER_{c,t-1} + \omega i_{US,t-1} + \varepsilon_{c,t} \end{aligned} \tag{12}$$

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, $i_{US,t-1}$[7] is the monetary policy 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 the spirit of 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.

[7] 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.

In some exercises we also include the years as an IT for each central bank,[8] 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 (12) 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:

$$\begin{aligned} i_{c,t} = \alpha_c + \rho i_{c,t-1} + \beta \pi gap_{c,t} + \gamma Ygap_{c,t} + \sum_{f \in F} z_c^f (\delta_f \pi gap_{c,t} + \tau_f Ygap_{c,t}) + \\ \theta \Delta NEER_{c,t} + \mu \Delta NEER_{c,t-1} + \omega i_{US,t-1} + \varepsilon_{c,t} \end{aligned} \tag{13}$$

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 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.

Finally, to explore whether the legacy of populism is amplified by current economic conditions (namely, the dispersion of inflation expectations or whether inflation is accelerating), we expand equation (13) as follows:

$$\begin{aligned} i_{c,t} = \alpha_c + \rho i_{c,t-1} + \beta \pi gap_{c,t} + \gamma Ygap_{c,t} + \sum_{f \in F} z_c^f (\delta_f \pi gap_{c,t} + \tau_f Ygap_{c,t}) + \\ + \sum_{f \in F} z_c^f \times q_{c,t} \times (\sigma_f \pi gap_{c,t} + \nu_f Ygap_{c,t}) + \\ \theta \Delta NEER_{c,t} + \mu \Delta NEER_{c,t-1} + \omega i_{US,t-1} + \varepsilon_{c,t} \end{aligned} \tag{14}$$

where now z_c^f captures exposure to past right- and left-wing populist regimes and $q_{c,t}$ is a variable capturing either disagreement about inflation expectations or accelerating inflation.

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

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

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.[9] In addition to data on median forecasts, we also collect data on the standard deviation of the surveys for each country survey as well as the maximum and minimum forecast. This allows us to explore how disagreement interacts with past populism to shape monetary policy.

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 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,

[9]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).

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.[10] Table B.1 describes the populist episodes from Funke et al. (2023). 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 for the 1960-2008 period). Note that data from the standardized surveys are available from the early 2000s to the present; however, changes in definitions used to measure central bank claims make it difficult to compare the standardized and non-standardized series. In addition to using the raw data, we identify events of abnormal increases in central bank financing.[11] 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 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. Table 1 lists the countries used in the different econometric analysis presented in the paper.

[10] 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."

[11] 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))

Table 1: Sample of Countries

Panel A. Local Projection Estimations	
Advanced Economies	Emerging Markets
AUS, AUT, BEL, CAN, CHE, CYP, CZE, DEU, DNK, ESP, EST, FIN, FRA, GRC, HRV, IRL, ISL, ISR, ITA, JPN, KOR, LVA, NLD, NOR, NZL, PRT, SVN, SWE, USA	BGR, BOL, BRA, CHL, CHN, COL, HUN, IDN, IND, MEX, MYS, PER, PHL, PRY, THA, TUR, URY, ZAF
Panel B. Taylor Rule Estimations	
Advanced Economies	Emerging Markets
AUS (1993), CAN (1992) CZE (1997) GBR (1992), ISR (1997), KOR (2001) NOR (2001), NZL (1989), SWE (1993)	ALB (2009), BRA (1999), CHL (1999) COL (1999), DOM (2012), GEO (2009 GTM (2005), HUN (2001), IDN (2005) IND (2015), KAZ (2015), MDA (2013) MEX (2001), PER (2003), PHL (2002) POL (1998), PRY (2013), ROU (2005) RUS (2015), SRB (2006), THA (2000) TUR (2006), ZAF (2000)

Note: In Panel B, year of IT adoption in parenthesis.

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.[12] One challenge of the 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

[12]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."

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.

Taking advantage of the novel database of populism regimes in Funke et al. (2023), 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.

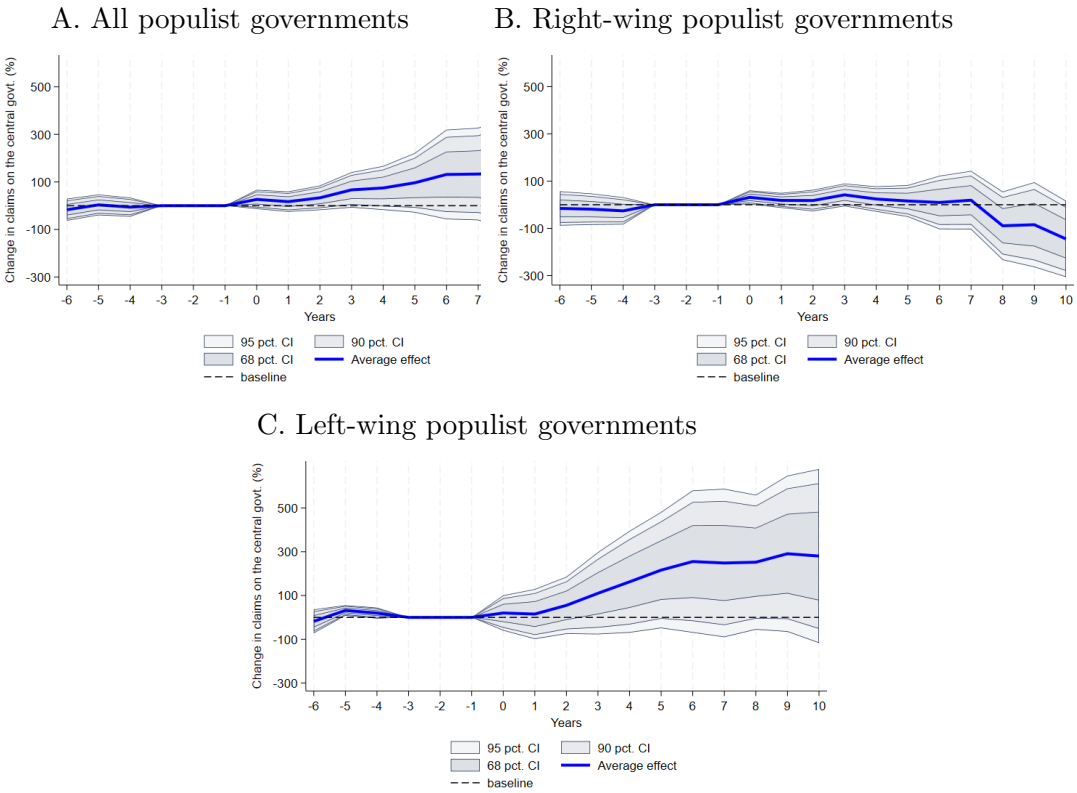
Note that, despite the fact that the definition of populism itself is typically detached from economic outcomes, the emergence of populist regimes may be affected by past economic performance or the expectation of economic challenges going forward. For example, a leader whose political speech satisfies the conditions to be classified as populist, may still be elected due to economic considerations. Thus, the empirical analysis below is still subject to endogeneity concerns, for which reason the patterns found in the analysis should be treated as associations. Nevertheless, such associations provide interesting patterns that are consistent with historical experiences and existing work.

We begin by documenting the link between populist governments and central bank credit. Figure 1 shows the change in central bank credit in the aftermath of a new populist regime 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 to the treatment nor in 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 do-

Figure 1: 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 10 and 11. Standard errors are calculated following the Driscoll-Kraay method. Shaded areas represent 68 percent (one standard deviation), 90 percent, and 95 percent confidence intervals

mestic 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 1 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 2, 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 1, 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 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 1, 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).

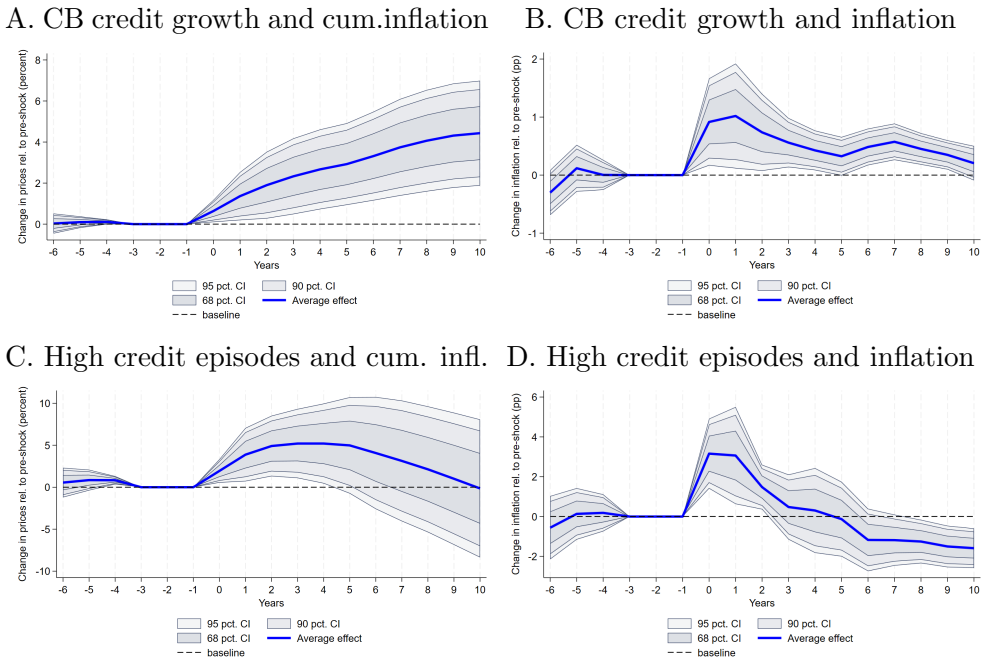
Figure 2 highlights the positive association between central bank credit to the central government and inflation. A one standard deviation increase in the central bank credit is associated with 3-4 percent cumulative increase in prices over a 10 year horizon relative to a country where CB credit remains 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

Table 2: 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

Figure 2: Central Bank Credit and Inflation



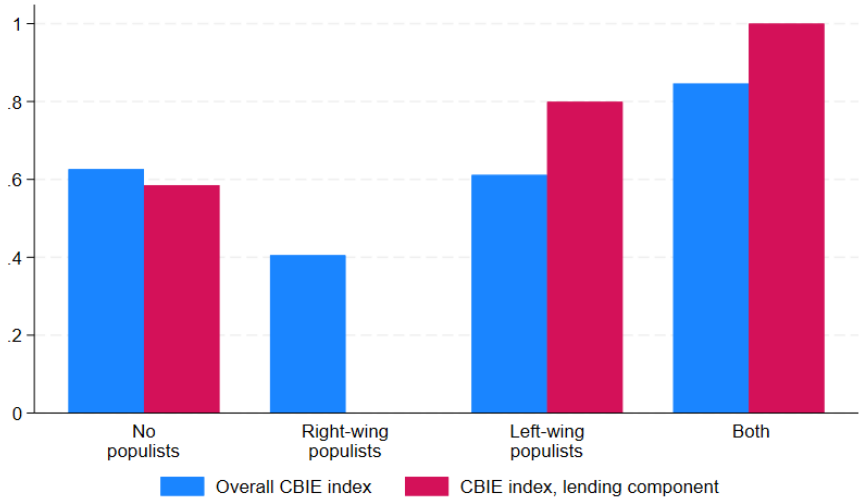
Notes: This figure plots the relationship between central bank credit and inflation. Panels A and C plot the cumulative change in inflation over the projection horizon, that is the difference between lnp_{t+h} and lnp_{t-1}, while Panels B and D plot the change in the inflation rate, that is $\pi_{t+h} - \pi_{t-1}$. Panels A and B show the dynamic association with a 1 SD change in central bank claims on the central government, while C and D show the response in the aftermath of a high CB credit growth episode. Results follow the specifications in equations 9. Standard errors are calculated following the Driscoll-Kraay method. Shaded areas represent one standard deviation (68 percent), 90 percent and 95 percent confidence intervals

to the one standard deviation shock, however, the association with high CB credit episodes is 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) show that 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 3, when focusing on countries following IT regimes and zooming

Figure 3: 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.

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).[13] Consistent with the previous section, countries with a history of left-wing populism also have, on average, 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), who show that 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

[13]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.

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 13 and allow the coefficients for the inflation and output gap to be functions of a country's past history.

Results in Table 3 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.[14] 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

[14]Prior history of abnormal central bank credit stands for a country-level dummy equal to one if 10 years before adopting inflation targeting, the country experienced at least one episode of abnormal central bank credit.

dominance.[15]

Motivated by the link between populism and central bank credit illustrated in section 4.1, column 4 shows results for a version of equation 13 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 pattern is confirmed in column (7), where we include all three sets of interactions simultaneously: interactions of the inflation and output gaps with exposure to left-wing populism, with exposure to abnormal central-bank lending, and with pre-IT inflation. In this specification, only the interactions involving left-wing populism and pre-IT inflation remain

[15]One could wonder if the current fiscal policy is "active" in the sense of Leeper and Benigno-Woodford, then monetary policy either needs to be sufficiently aggressive to force fiscal adjustment or must accommodate the fiscal authority. In other words, that the stronger monetary response in post-populist countries may not reflect institutional memory or a behavioral residue so much as a feature of the current fiscal-monetary policy environment, with the elevated $\phi_p i$ being what is needed to keep the economy in a determinate equilibrium and prevent expectations from drifting toward the fiscal-dominance outcome. However, one can show that under fiscal dominance determinacy requires the monetary policy to be passive rather than aggressive in its response to inflation. Put differently, if the regime is fiscally dominant and monetary policy is active, then a locally bounded equilibrium ceases to exist. This implies that, within the Leeper (1991) framework, the finding that countries with a history of populism respond more aggressively to inflation cannot be explained by their currently operating under a fiscally dominant regime.

statistically significant, suggesting that past central-bank lending does not have an independent effect once these other historical channels are controlled for.[16]

[16]One may wonder about the "recency effect," as in Malmendier and Nagel (2016). Our regressions do not find a statistically significant decay in the response of central banks to inflation deviation shocks, however. This could reflect an underlying fragility of expectations that is structural, and gets reactivated by shocks. As elaborated in the paper, this is consistent with a central bank that internalizes the public's experienced-based expectations (as they shape the environment in which the central bank operates).

Table 3: 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 12-13 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

Results in Table 3 provide interest insights regarding the relationship between past inflation, fiscal monetization and populism. The first thing to note is that, as expected, when we control for past inflation, the coefficient for the interaction between the inflation gap and central bank lending and the coefficient for the interaction between the inflation gap and exposure to left-wing populism is typically smaller in magnitude compared to the specification where we do not control for past inflation. This suggests that part of the higher sensitivity to the inflation gap found in countries with a past history of left-wing populists and/or high levels of central bank lending reflects a history of high inflation. However, that is not the end of the story, as even when we control for past inflation, the variables capturing past fiscal populism remain significant. While not directly tested in the paper, this could be linked to a persistent fear of institutional erosion and de-anchoring. This is consistent to the fact that, in our data, left-leaning government are only present in EMDEs, which are expected to have weaker de facto institutional settings. Note that for the shadow of populism to loom large, even in the absence of past high inflation episodes, the threat of government intervention and monetization does not have to be operative, it just needs to hang over economic agents such that it affects its formation expectation. This is the separate channel through which the legacy of fiscal populism can affect monetary policy—the credibility/institutional channel, which as shown in Jácome et al. (2025a) and Jácome et al. (2025b) in the context of past high inflation, can have protracted effects on monetary policy. Central banks operating under this shadow have more independent charters (Figure 3) and respond more aggressively to the inflation gap, presumably to signal operational independence and to keep inflation expectations anchored.

4.3 Amplifiers of the Legacy of Fiscal Populism

So far we have documented how countries with a history of (fiscal) populism are more prone to tighten monetary policy when facing a larger inflation gap. Next we explore when these central banks are more likely to respond more aggressively to deviations from the inflation target.

Before exploring potential amplifiers of the legacy of past populism, columns (1) and (2) of Table 4 present results for the baseline specification in which we explore the role of past populism (as in column (4) of Table 3) for two samples—our full sample (column 1) and a restricted sample with only countries that have information on the dispersion of inflation forecasts (column 2). As shown, results in the two samples are in line, with the legacy of past left-wing populism becoming stronger in the more restricted sample. One possibility is that the shadow of past populism looms larger in moments of high inflation disagreement, another sign of potential de-anchoring. We explore the role of disagreement by constructing two gauges. One is a dummy variable that takes value one when the coefficient of variation (CV) of inflation expectations in the specific survey is higher than the country-specific median of the CV, the second is a dummy that takes value one when the dispersion of forecasts (the max-min difference normalized by the median forecast) is higher than the country-specific median of the dispersion gauge.

Column (3) of Table 4 shows that central banks with a legacy of left-wing populism tend to respond more strongly in times of forecast dispersion (i.e., moments of disagreement). By

contrast, and consistent with the baseline results, having a right-wing legacy does not systematically affect the response of monetary policy to the inflation gap. Note that results hold when we also allow disagreement to affect the response to the output gap (column 4). Next we assess the robustness of our results to using our alternative measure of disagreement, the dispersion of forecasts. As column (5) illustrates, results are qualitatively in line to those using the CV—central banks with a legacy of populism, especially left-wing populism, respond more strongly to deviations of inflation expectations from the target in times of high dispersion. In column (6), in addition to allowing the interaction between the inflation gap and past populism to be affected by disagreement, we also allow the average response of all countries (even those without a populist past) to be affected by high dispersion. The key insight of this exercise is that the difference in the response of central banks in countries with a populist past and those that do not have a populist past widens in times if high disagreement. Finally, column 7 explores whether inflation dynamics affect the response of central banks in countries with a populist past. Results indicate that when inflation accelerates, IT central banks in countries with a history of past left-wing populism act more aggressively to deviations from the target. Thus, results indicate that the legacy of populism is activated by disagreement and rising inflation.

4.4 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 depreciation can have an adverse effect on inflation.

Table 4: The Role of Past Exposure to Populism and Abnormal Central Bank Lending on Monetary Policy

VARIABLES	(1) Policy rate	(2) Policy rate	(3) Policy rate	(4) Policy rate	(5) Policy rate	(6) Policy rate	(7) Policy rate
Policy rate (t-1)	0.8634***	0.8324***	0.8317***	0.8304***	0.8315***	0.8265***	0.8610***
	(0.0307)	(0.0398)	(0.0401)	(0.0401)	(0.0399)	(0.0401)	(0.0325)
XR depreciation	-0.0183*	-0.0159	-0.0166	-0.0171	-0.0166	-0.0177	-0.0173
	(0.0110)	(0.0136)	(0.0135)	(0.0134)	(0.0135)	(0.0136)	(0.0109)
XR depreciation (t-1)	0.0191*	0.0221*	0.0219*	0.0222*	0.0221*	0.0238**	0.0191*
	(0.0100)	(0.0115)	(0.0118)	(0.0118)	(0.0118)	(0.0118)	(0.0100)
US Pol. rate (t-1)	0.0943***	0.1267***	0.1243***	0.1267***	0.1249***	0.1290***	0.0947***
	(0.0279)	(0.0343)	(0.0344)	(0.0345)	(0.0341)	(0.0337)	(0.0295)
Output gap	0.0589***	0.0781***	0.0731***	0.0715***	0.0746***	0.0669***	0.0585***
	(0.0125)	(0.0230)	(0.0249)	(0.0249)	(0.0247)	(0.0235)	(0.0125)
Inflation gap (expected inf)	0.2023***	0.1541**	0.1549**	0.1552**	0.1546**	0.4088***	0.2028***
	(0.0726)	(0.0718)	(0.0714)	(0.0714)	(0.0715)	(0.0776)	(0.0734)
Inf. gap x Past right-wing populist	0.0322	0.0459*	0.0345	0.0322	0.0417	-0.0013	0.0299
	(0.0232)	(0.0250)	(0.0275)	(0.0290)	(0.0265)	(0.0269)	(0.0251)
Output gap x Past right-wing populist	0.0005	-0.0024	-0.0019	-0.0084	-0.0020	-0.0003	0.0006
	(0.0043)	(0.0042)	(0.0046)	(0.0111)	(0.0046)	(0.0045)	(0.0044)
Inf. gap x Past left-wing populism	0.0288***	0.0340***	0.0219***	0.0224***	0.0229***	0.0113*	0.0238**
	(0.0096)	(0.0094)	(0.0065)	(0.0064)	(0.0062)	(0.0061)	(0.0104)
Output gap x Past left-wing populism	0.0009	-0.0006	-0.0004	-0.0044*	-0.0004	0.0000	0.0010
	(0.0015)	(0.0012)	(0.0013)	(0.0023)	(0.0013)	(0.0013)	(0.0015)
High CV of inflation expectations			-0.0994	-0.1063		-0.0229	
			(0.0716)	(0.0699)		(0.0804)	
High CV x Inf. gap x Past left-wing populism			0.0154**	0.0144*		0.0262***	
			(0.0077)	(0.0076)		(0.0090)	
High CV x Inf. gap x Past right-wing populism			0.0200	0.0203		0.0519	
			(0.0287)	(0.0298)		(0.0334)	
High CV x Output gap x Past right-wing populism				0.0073			
				(0.0137)			
High CV x Output gap x Past left-wing populism				0.0050*			
				(0.0029)			
High inflation dispersion					-0.0720		
					(0.0646)		
High inf. disp. x Inf. gap x Past left-wing populism					0.0146*		
					(0.0085)		
High inf. disp. x Inf. gap x Past right-wing populism					0.0068		
					(0.0281)		
High CV x Inf. gap						-0.2586***	
						(0.0986)	
$\Delta\pi$ x Inf. gap x Past left-wing populist							0.0038**
							(0.0016)
$\Delta\pi$ x Inf. gap x Past right-wing populist							0.0119
							(0.0212)
Observations	2,617	1,965	1,965	1,965	1,965	1,965	2,595
Number of countries	32	22	22	22	22	22	32
Time FE	NO	NO	NO	NO	NO	NO	NO
Years as IT FE	NO	NO	NO	NO	NO	NO	NO
Adjusted R-squared	0.904	0.895	0.896	0.896	0.896	0.898	0.903

Note: This table reflects equation 14 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

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 5: 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 3 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 5 shows that, as was the case in Table 3, 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 6, 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 5 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, they

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

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 no 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 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 6: 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

A Case Studies

A.1 Argentina

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. Funke et al. (2023) distinguishes eight episodes of populism starting in 1916. Because the focus of this paper starts in 1960, we zoom into five of those populist episodes.[19] Four of them are left-leaning and the other one is right-leaning: Perón–Martínez, 1973–1976 (left); Menem, 1989–1999 (right); Néstor Kirchner, 2003–2007 (left); Cristina Kirchner, 2007–2015 (left); and Fernández, 2019–2023 (left). In most of these episodes, expansionary fiscal policies were a common feature, financed by the Central Bank of the Republic of Argentina (BCRA), either through direct credit or via seigniorage. Fiscal dominance implied an erosion of BCRA's political independence, which ultimately undermined monetary policy credibility.[20]

With the exception of Néstor Kirchner's period, fiscal policy implemented by left-wing governments relied on central bank financing, whereas the right-wing episode in the 1990s did not (see Figure A.1). During the Perón-Martínez years, a reform of the central bank law expanded the room to finance the government, up to 30 percent of the average revenues received by the government in the last 12 months—doubling the previous cap—, charging interest rates well below market rates, at a level effectively negative in real terms.[21] The reform was part of a broad government approach that placed improving social conditions at the core of its political agenda. Central bank policies were part of this agenda and, hence, the new law expanded the BCRA's mandate to include several objectives such as maintaining an ordered and growing economic development with a social approach, high occupation, and a stable currency.[22] In response, inflation soared to unprecedented levels, reaching more than 700 percent by mid-1976.

The Menem administration passed a new central bank law in 1992, which imposed strong restrictions on BCRA's financing to the government.[23] It was part of a comprehensive pro-

[19] The 1980s and early-1990s, as well as the early 2000s are particular periods that were not associated with populist governments. In the first half of the 1980s, central bank credit to the government surged because Argentina defaulted on its external debt, leaving the BCRA as the only source of its financing. This was compounded by the impact of the systemic financial crisis that hit the country in the early 1980s, which entailed the BCRA bailing out depositors, banks, and firms, which, to some extent, involved discounting government paper (see Baliño (1991)). In the second half of the decade, still without access to private sector financing, the central bank kept printing money to finance the government amid successive failed stabilization policies, which led to rising inflation expectations and, thus, run-away inflation. The early 2000s, when the currency board arrangement established in 1991 collapsed, a new episode of debt default and systemic financial crisis hit the country. Central bank net credit to the government surged—it increased more than money base—as documented in BCRA (2003).

[20] The BCRA was established in 1935 with a high level of independence, in particular with respect to printing money to finance the government. However, starting in 1946, such independence was gradually eroded. And while in 1991 it was reestablished, it was again undermined, especially from 2008 onward. See the work by Jácome (2026) for a discussion of the evolution of central bank independence in Argentina in the context of the rest of Latin America.

[21] See Law 20.539 from October 1973.

[22] The banking system was nationalized with the intention of directing bank credit to small enterprises, cooperatives, and households.

[23] See Law 24.144.

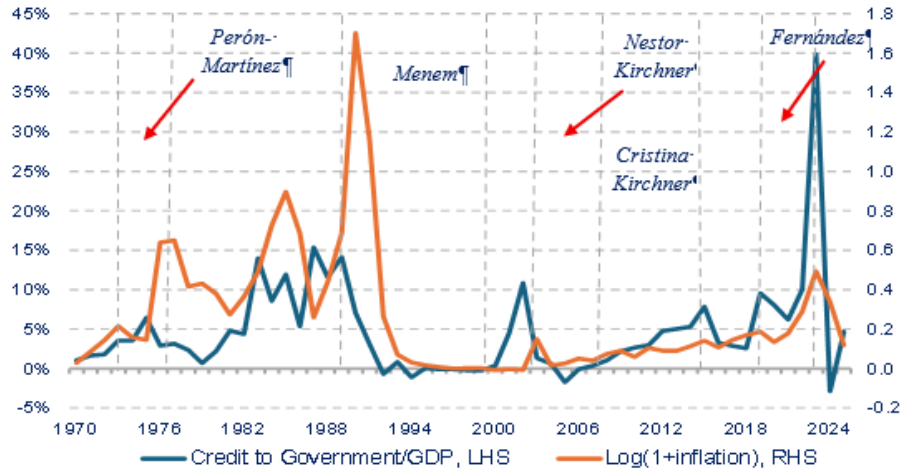
gram to tackle hyperinflation, which had crippled economic activity and devastated the country socially in the late-1980s and early-1990s. The new legislation aimed to secure the BCRA's political independence and to align its responsibilities to the functioning of the Currency Board Arrangement (CBA), narrowing the central mandate to focus on price and financial stability. Operationally, the BCRA's was allowed to hold government bonds up to 1/3 of total freely available international reserves as defined by the Convertibility Law and could not increase it more than 10 percent in a year. Against this backdrop, inflation plunged and remained stable at about one percent on average between 1994 and 2001.

The collapse of the CBA in 2002 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 maintaining the BCRA's mandate unchanged. The room for financing was restricted to no more than 10 percent of the revenues received by the government in the last 12 months, without defining the interest rate to be charged. 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, which effectively implied granting direct credit to the government. This exemption was expanded in late-2008 to include the payment of other debt obligations denominated in foreign exchange.[24] In addition, the 2003 legislation allowed the BCRA to transfer to the government unrealized profits resulting from the increase in the peso value of international reserves derived from the peso depreciation. Unrealized profits increased as the peso depreciation gained momentum in 2009, which in turn responded, to a great extent, to the increase in BCRA's credit to the government, thereby creating a vicious cycle that fueled a rise in inflation from 2010 onward.

Still during the Cristina Kirchner period, the government passed Law 26.739 in 2012, which reformed central bank legislation, deepening fiscal dominance. In addition to the previous provisions by which the BCRA is authorized to extend transitory advances to the government, this law allowed 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 reform also changed the central bank mandate assigning it conflicting objectives. The BCRA was mandated 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." The new legislation thus severely undermined BCRA's independence. This new institutional arrangement of monetary policy also ruled the Fernandez period, which required the BCRA to print money persistently to finance fiscal expenditure. As a result, inflation surged reaching three-digit rates. Printing money to finance the government accounted to close to 40 percent of GDP in 2023.

[24] See Law 26.422 (article 72) from November 2008, which approves the government budget for 2009.

Figure A.1: Central bank credit to the government and inflation in Argentina (1970–2025. In percent of GDP and log (1+inflation))



Notes: This figure plots the central bank credit to the government (in percent of GDP) and (1+log) inflation in Argentina during 1970-2025.
Source: Central Bank of Argentina.

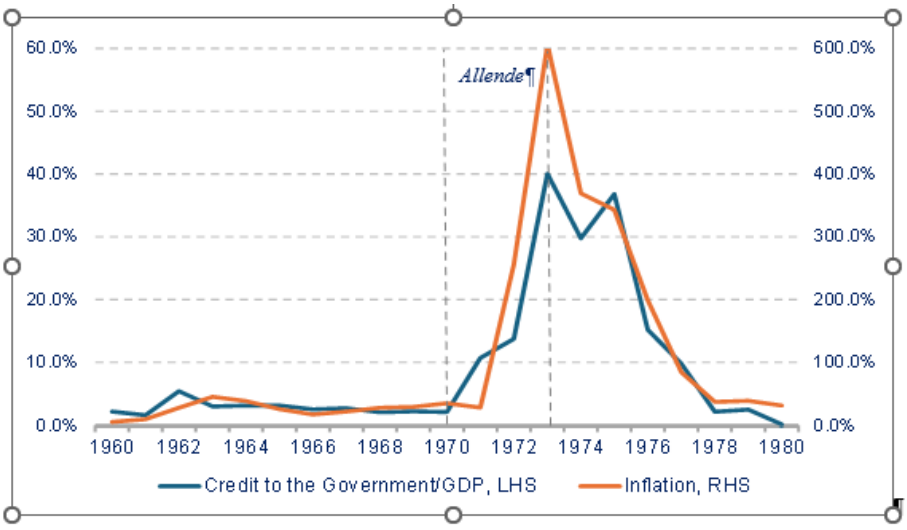
A.2 Chile

Chile elected a left-wing government—President Salvador Allende—that implemented economic policies disregarding budgetary and external constraints and dismissing the benefits of market conditions for resource allocation. Instead, the government set price controls, expanded aggregate demand, increased government participation in the economy, and took full control of monetary policy. Rather than amending the central bank law, the Chilean government issued a series of laws authorizing the central bank to print money to finance the public sector without violating established limits in the central bank charter.[25] Consequently, credit to the non-financial public sector skyrocketed, reaching about [40 percent of GDP] in 1973 (see Figure 2.A).

While populist economic policies initially succeeded in keeping inflation low and boosting economic growth, they ultimately created growing economic imbalances that reversed these early gains. Over time, inflation spiraled out of control, reaching about 600 percent in Chile in 1973, while output growth turned negative. The uptick of economic growth while inflation remained subdued is explained because, initially, the economy had idle capacity, and the central bank held sufficient international reserves. This allowed the government to respond to production stimulus and expansionary aggregate demand while maintaining a fixed exchange rate and price controls to keep inflation artificially low. However, growth could not be sustained, as excessive demand for domestic goods and imports led to bottlenecks, steadily depleting foreign exchange reserves and triggering currency devaluations. Eventually, expansionary policies fed inflationary pressures because, simultaneously, printing money to finance the government multiplied (see Figure 2.A). Economic populism in Chile was short-lived, as the socialist government was overthrown in 1973. The new non-democratic government took full control of the central bank but shifted the

[25]This legislation is detailed in the Central Bank of Chile's Annual Reports 1970–1973.

Figure A.2: Central bank credit to the government and inflation in Chile (1960–1979. In percent of GDP and annual percent rates)



Notes: This figure plots the central bank credit to the government (in percent of GDP) and (1+log) inflation in Chile during 1960-1979.
Source: Central Bank of Chile.

focus of monetary policy toward controlling inflation while restoring market conditions for price formation. Fiscal dominance gradually declined as the core of the anti-inflation strategy was to reduce the fiscal deficit. [26]

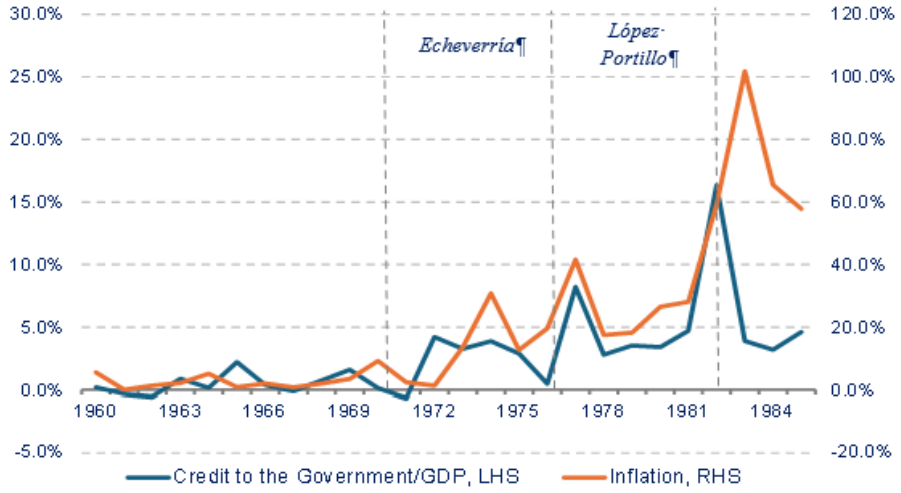
A.3 Mexico

Starting in the 1970s, Mexico moved from the "stabilization development" phase in place since the mid-1950s, in which fiscal policy was in check and inflation was low, to a populist macroeconomic period. This economic policy lasted until 1982 when the country endured a triple crisis—currency, banking, and sovereign debt. Two presidents were in power during those 12 years, First, President Echeverría (1970-1976) and then President López Portillo (1976-1982). Their populist approach was not the same. Echeverría's administration had a confrontational attitude toward the private sector.[27] It rather boosted public investment, emphasizing the creation of public enterprises and implementing growing social spending, financed with external debt and by requiring the central bank to print money to fund the government coffers. Central bank credit to the government accounted for close to 5 percent of GDP during most of its period, which fueled inflation, hitting a historical record high in 1974—more than 30 percent. Moreover, the persistent expansion of aggregate demand led to a major currency crisis in 1976. López Portillo's approach sought to restore a good relationship with the private sector. In general, the first years of his administration aimed to "please all," not only the private sector.

[26] This approach was complemented by various structural reforms aimed at improving resource allocation, including cutting import tariffs, liberalizing financial sector policies, and opening the capital account to attract capital inflows.

[27] See Bazdresch and Lev (1991) .

Figure A.3: Central bank credit to the government and inflation in Mexico (1960–1985. In percent of GDP and annual percent rates)



Notes: This figure plots the central bank credit to the government (in percent of GDP) and (1+log) inflation in Chile during 1960-1985.
Source: Central Bank of Mexico.

The government implemented price subsidies, kept an overvalued exchange rate, and developed major infrastructures projects that benefited the rural areas. As the fiscal deficit grew so did external debt and central bank financing and, thus, inflation remained elevated. These policies proved unsustainable, in particular, because the external environment turned negative due to the rapid increase in the US interest rates, which pushed Mexico to default on its sovereign debt in 1982.

B List of Populist Governments

Table B.1: Populist Government Episodes, 1900–2020

Country	Years	Leader(s)	Ideology
Argentina	1916–1930; 1946–1955; 1973–1976; 1989–1999; 2003–2015	Yrigoyen; Perón; Martínez; Menem; Kirchner–Fernández	L; L; L; R; L
Bolivia	1952–1964; 2006–2019	Estenssoro–Zuazo; Morales	L; L
Brazil	1930–1945; 1951–1954; 1990–1992; 2019–	Vargas; Collor; Bolsonaro	L; R; R
Chile	1920–1938; 1952–1958	Alessandri–Ibáñez	L
Ecuador	1934–1972; 1996–1997; 2007–2017	Velasco; Bucaram; Correa	R; R; L
Germany	1933–1945	Hitler	R
Greece	2015–2019	Tsipras	L
Hungary	2010–	Orbán	R
India	1966–1977; 2014–	Gandhi; Modi	L; R
Indonesia	1945–1966; 2014–	Sukarno; Widodo	L
Israel	1996–1999; 2009–	Netanyahu	R
Italy	1922–1943; 1994–2011; 2018–	Mussolini; Berlusconi; Lega/M5S	R
Japan	2001–2006	Koizumi	R
Mexico	1934–1940; 1970–1976; 2018–	Cárdenas; Echeverría; López Obrador	L
Peru	1985–1990; 1990–2000	García; Fujimori	L; R
Philippines	1998–2001; 2016–	Estrada; Duterte	L; R
Poland	2005–2007; 2015–	PiS (Kaczyński)	R
Slovakia	1990–1998; 2006–2018	Mečiar; Fico	R; L
South Africa	2009–2018	Zuma	L
South Korea	2003–2008	Roh	R
Taiwan	2000–2008	Chen	R
Thailand	2001–2006	Shinawatra	R
Turkey	2003–	Erdoğan	R
United Kingdom	2019–	Johnson	R
United States	2017–	Trump	R
Venezuela	1999–	Chávez–Maduro	L

Notes: This table summarizes populist leadership episodes identified in the dataset of Funke et al. (2023). Episodes combine consecutive leader spells of similar ideology or short interruptions. "L" and "R" denote left- and right-wing populism, respectively. Dates refer to years in office.

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