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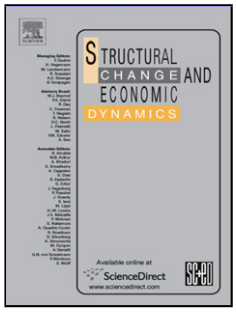


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# The New Keynesian Framework for a Small Open Economy with Structural Breaks: Empirical Evidence from Peru*

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**Abstract**

We present evidence from Peru that the New Keynesian Phillips Curve, Dynamic IS and Taylor Rule derived by Galí and Monacelli (2005) are unstable. The results from methodology of Bai and Perron (1998, 2003) suggest that the change of the policy rule (January 2006 and May 2009) induces a break in the inflation process (January 2008) and in the market equation (October 2008); the latter due to the existence of nominal frictions and incomplete information in the Peruvian economy. Moreover, results from the estimation of the method of Qu and Perron (2007) reaffirm that there are breaks in the entire reduced system (May 2008 and May 2010). In both cases, the channel of expectations is strengthened since 2008 and it is related to changes in the monetary policy during those years. Furthermore, we also discuss and estimate the presence of the nominal exchange rate in the policy rule.

**JEL Classification:** C32, C51, E31.

**Keywords:** Structural Breaks, New Keynesian Phillips Curve, Dynamic IS, Taylor Rule, Peruvian Economy.

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