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Disagreement in expectations about public debt, monetary policy credibility and inflation risk premium

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Highlights

- Estimates suggest public debt expectations affect the inflation risk premium in Brazil.
- Disagreement in expectations about public debt affects the inflation risk premium.
- Monetary policy credibility is able to reduce the inflation risk premium.

Abstract

This paper analyzes the determinants of the inflation risk premium in Brazil during the Inflation Targeting period. In particular, different from the existing studies, we analyze the influence of both public debt expectations and disagreement in expectations about public debt on the inflation risk premium, and also the effect of monetary policy credibility on the inflation risk premium. The findings bring two important policy implications. One related to the effect of the expectations formed for the commitment of the government with debt management; and the other related to the effect of the expectations formed for the central bank's commitment with the Inflation Targeting regime. The results suggest the disagreement in expectations about the public debt affects the inflation risk premium. Furthermore, the findings also suggest the degree of anchorage of inflation expectations in relation to the inflation target (i.e., the monetary policy credibility) affects the inflation risk premium.

Keywords: disagreement in expectations; risk premium; interest rate; credibility

JEL classification: E31, E43, E52.

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