

Fiscal Credibility and Inflation Hysteresis: A Regime-Dependent Fourier Panel Approach

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Abstract

This study investigates whether inflation shocks generate persistent or hysteresis-type effects under different monetary and fiscal credibility regimes by integrating an institutional perspective into the inflation dynamics literature. Covering the period 1995-2024, the analysis compares core Euro Area economies operating under a supranational monetary framework with Poland and Turkey as sovereign regimes. Methodologically, the study employs Fourier-based panel unit root techniques, which allow for the identification of smooth and unknown structural changes rather than relying on sharp break assumptions. In addition, inflation is filtered from key macroeconomic Fundamentals including output gap, credit growth, fiscal stance, exchange rate movements, and unemployment to isolate the institutional and credibility-driven component of inflation persistence. The empirical findings reveal that inflation dynamics are strongly regime-dependent. While inflation exhibits a high degree of persistence across countries, it does not follow a uniform stochastic trend; instead, it is generally trend-stationary around evolving policy regimes. Economies with stronger fiscal and monetary credibility particularly within the Euro Area display faster mean reversion, indicating that credible institutional frameworks limit the transformation of temporary shocks into permanent inflationary paths. In contrast, countries with weaker or evolving credibility structures show more pronounced persistence and path dependence, consistent with hysteresis-type behavior. Overall, the results suggest that inflation dynamics cannot be fully understood without accounting for institutional regime design, highlighting credibility as a central determinant of whether shocks dissipate over time or become embedded in the economic system.

Keywords: fiscal policy, monetary policy, inflation, institutional regime, fourier KPSS

Doi: <https://doi.org/10.66414/mlabs.9739>

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