EXCHANGE RATE PASS-THROUGH IN LATIN AMERICA: DOES DOLLARIZATION MATTER?

Vincent Notte

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Exchange rate pass-through in Latin America: Does dollarization matter?

Vincent Notte[1]

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Abstract

Despite extensive evidence that Exchange Rate Pass-Through (ERPT) has declined in both developing and advanced economies, the mechanisms behind it remain debated. This paper shows that shifts in dollarization can explain a substantial part of this decline in Latin America. Using panel data for seven countries from 1995–2019, we find that ERPT fell sharply from 42 to 15 percent. Lower dollarization significantly dampens ERPT: a one-percentage-point decline in dollarization reduces ERPT by 0.25 percentage points. This channel is quantitatively important—for example, in Peru, de-dollarization can explain a 10-percentage-point fall in ERPT over the sample period. Given the persistently high levels of dollarization in the region, further reductions could significantly dampen the ERPT. Our findings highlight dollarization as a central, yet previously underappreciated, determinant of ERPT.

Keywords: Exchange Rate Pass-Through; Dollarization; Inflation; Latin America;
JEL Classification: F31, F33, O54

[1] IRES/LIDAM, UCLouvain. Email: vincent.notte@uclouvain.be. I thank Vincent Bodart, Gonzague Vannoorenberghe, Romain Houssa, and Bertrand Candelon for their useful comments.

1. Introduction

Empirical research on exchange rate pass-through (ERPT) highlights two key patterns. First, the ERPT has declined markedly over the past three decades in both advanced and emerging economies (Campa and Goldberg, 2005; Choudhri and Hakura, 2006; Ortega & Osbat, 2020). Second, despite this general decline, the ERPT remained systematically higher in emerging and developing countries than in advanced ones (Carrière-Swallow et al., 2025). Taylor (2000) provided a foundational explanation for both the downward trend and cross-country heterogeneity, stressing the role of better-anchored inflation expectations and the transition to a low-inflation environment. Subsequent research emphasized that the ERPT depends on a number of structural factors, including monetary policy credibility and independence (Carrière-Swallow et al., 2016; Ortega et al., 2020; Borensztein et al., 2016), exchange rate arrangements and inflation targeting regimes (Ha et al., 2019; Borensztein et al., 2016), macroeconomic uncertainty (Carrière-Swallow et al., 2025), the currency used for trade invoicing (Gopinath et al., 2021; Boz et al., 2025), the composition of imports (Goldberg and Campa, 2010) and dollarization (Carranza et al., 2009; Reinhart et al., 2003; Alvarez-Plata and García-Herrero, 2008).

In this paper, we investigate whether, and to what extent, dollarization has contributed to the decline in ERPT to consumer prices in Latin America. While several studies have investigated the effects of dollarization, their analyses have generally been limited to relatively short sample periods and therefore do not assess its contribution to the longer-run decline in ERPT. Moreover, these studies focus primarily on the 1990s and early 2000s and do not incorporate the substantial changes in dollarization and monetary policy frameworks observed over the past two decades. This paper provides the first systematic evidence that declining dollarization has been an important driver of the long-run decline in ERPT in Latin America. Using a monthly dataset for seven countries over 1995–2019 and a local-projection framework, we show that de-dollarization has reduced the sensitivity of consumer prices to exchange rate fluctuations—accounting for a sizable share of the fall in ERPT since the mid-1990s. In doing so, the paper uncovers a previously underappreciated mechanism affecting the ERPT.

While dollarization can take multiple forms, our analysis focuses on deposit dollarization, defined as the share of bank deposits in foreign currency. Two stylized facts motivate this focus. First, deposit dollarization has been persistently high in Latin America since the 1990s (Levi-Yeyati, 2021), raising concerns about its implications for key macroeconomic outcomes, including inflation, economic and financial stability. Second, average deposit dollarization in the region has declined steadily since the early 2000s (Levi-Yeyati 2021), coinciding with the documented fall in ERPT (Taylor 2000; Carrière-Swallow et al., 2025). These patterns raise the question of whether deposit de-dollarization has played a role in dampening the transmission of exchange rate movements to domestic prices.

Deposit dollarization can influence the ERPT through two main distinct channels, depending on whether we consider demand or term deposits. Dollarization of demand deposits reflects currency substitution and the indexation of prices to foreign currency (Drenik et al., 2021; Levy-Yeyati, 2021)[2]. A higher dollarization of demand deposits implies that a larger fraction of domestic prices co-move with the exchange rate, thereby mechanically increasing the ERPT. In contrast, dollarization of term deposits primarily captures financial dollarization—the extent to which assets and liabilities are denominated in foreign currency. A greater reliance on foreign-currency term deposits can weaken monetary policy transmission, as these liabilities fall outside the central bank's direct control (Bahmani-Oskooee and Domac, 2002; Ize and Levy-Yeyati, 2006)[3]. This weakens the central bank's capacity to stabilize inflation and can therefore affect the ERPT indirectly. Because our measure of dollarization does not distinguish between demand and term deposits, the estimates in this paper capture the average effect of both channels.

Our results yield two key findings. First, we document the variation in ERPT over time using rolling-window estimations. Consistent with previous evidence (Carrière-Swallow et al., 2025; Taylor, 2000), we find a marked and gradual decline in average ERPT, from approximately 42 percent in 1995-2004 to 15 percent in 2010-2019. These results remain robust to controlling for foreign producer prices, output growth, lagged inflation, and both country and time fixed effects. Second, we quantify the contribution of deposit dollarization to the decline in ERPT. We find that a one-percentage-point reduction in dollarization is associated with a 0.25 percentage-point decrease in ERPT. For a country such as Peru—where dollarization has fallen substantially—this channel alone accounts for a 10 percentage-point reduction in ERPT. Given that dollarization remains elevated in the region, further de-dollarization could meaningfully dampen the ERPT going forward. Overall, these results underscore the central role of dollarization in shaping ERPT dynamics and highlight the macroeconomic benefits of continued de-dollarization efforts.

The rest of the paper is organized as follows. Section 2 describes the data. Section 3 outlines the methodology, discusses potential endogeneity concerns, and presents the estimates for the time variation in ERPT. Section 4 presents the main results. Section 5 reports the robustness checks. Section 6 concludes.

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[2] Drenik et al. (2021) show that the share of goods whose price is indexed in the USD is highly correlated with the share of bank deposits in USD.

[3] Acosta-Henao et al. (2025) find that monetary policy has a more muted effect on bank credit when financial dollarization is high.

2. Data

Our sample includes seven Latin American countries (Chile, Costa Rica, Guatemala, Mexico, Paraguay, Peru, and Uruguay) from January 1995 to December 2019. We focus on Latin American countries that exhibit sufficient exchange rate flexibility over the sample period, excluding pegged regimes such as Bolivia, and for which data on dollarization are available. To avoid structural breaks, countries such as Argentina, Venezuela, and Nicaragua — which experienced episodes of sharp regime shifts and hyperinflation —are excluded.

Our primary variables of interest are the log change in the consumer price index (ΔP), the log change in the bilateral exchange rate against the U.S. dollar[4] (ΔUSD) –where an increase denotes a depreciation of the local currency–, the log change in real GDP (ΔGDP), the log change in trade-weighted foreign CPI[5] (ΔPPI), and the share of bank deposits denominated in foreign currency (*Doll*). This latter variable serves as our measure of dollarization[6]. We also include a binary indicator for the adoption of inflation targeting (IT) and a measure of de facto exchange rate regimes (*Regimes*). For one of our robustness checks, we also include the log change in global oil prices (see section 5.2).

All variables are available at a monthly frequency, except for real GDP –quarterly– , and the inflation-targeting and exchange rate regimes indicators, which are annual. To ensure consistency across variables, quarterly GDP is converted to a monthly frequency by replicating the quarterly value across the three months of the corresponding quarter. Similarly, for the inflation-targeting and exchange rate regimes, annual values are replicated across the twelve months of the corresponding year. The main source of data is the IMF's Latin Macro Watch database. Information on inflation-targeting adoption comes from De Gregorio (2019) and central-bank websites; effective exchange rates are obtained from Darvas (2021); de facto exchange rate regimes are based on Ilzetzki et al. (2019), and information on global oil prices is obtained from the Intercontinental Exchange (ICE) dataset. Appendix 1 lists all variables with their respective sources.

Table 1 reports summary statistics for the main variables. Average monthly inflation is 0.52 percent, while the average monthly change in the exchange rate is 0.33 percent. The highest monthly inflation in the sample is around 8 percent (18 percent at annual frequency), while the largest monthly currency depreciation is 25 percent (76 percent at annual frequency).

[4] The use of the bilateral exchange rate is in line with Gopinath et al. (2020) and Boz et al. (2025), who show that the US dollar is the most frequently used currency to invoice trade in Latin America.

[5] The log change trade-weighted foreign CPI is a proxy for foreign production costs. It is constructed following the methodology proposed by Campa and Goldberg (2005), and uses data on the real effective exchange rate and nominal effective exchange rate. We obtain those data from Darvas (2021).

[6] This measure of dollarization is commonly used in the literature (see Levi-Yeyati 2006 and Levi-Yeyati 2021).

Deposit dollarization level is also substantial: on average, 42 percent of bank deposits are denominated in foreign currency.

TABLE 1. Summary statistics

	Mean	StD. Dev	Min	Max	Obs
ΔP (m/m % change)	0,52	0,66	-2,3	7,7	2093
ΔUSD (m/m % change)	0,33	2,1	-8,9	24,8	2093
ΔGDP (Q/Q % change)	0,26	0,99	-6,7	9,2	1985
$Doll$ (%)	42,2	25,1	0,83	92	1787
ΔPPI (m/m % change)	0,30	0,35	-0,97	2,4	2093

Note: Unbalanced dataset from 1995m1 to 2019m12. Includes 7 Latin American countries (Chile, Costa Rica, Guatemala, Mexico, Paraguay, Peru, and Uruguay).

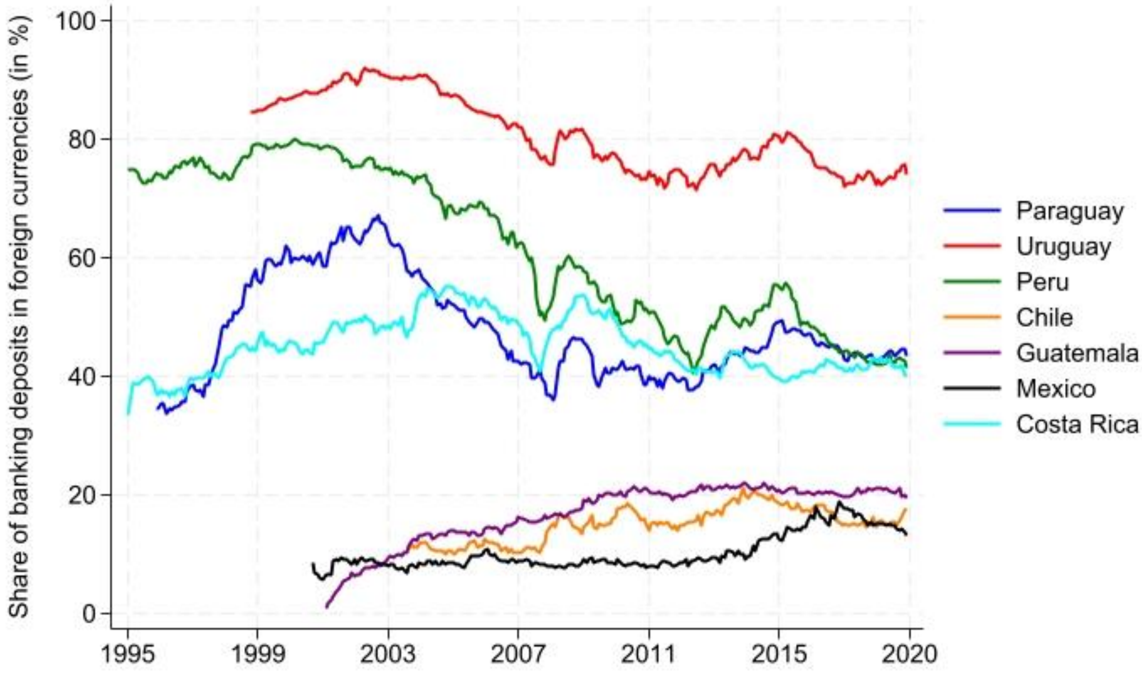
Figure 1 displays the evolution of deposit dollarization[7] for each country in our sample. Countries that were highly dollarized in the 1990s (such as Peru and Uruguay) experienced a pronounced decline in deposit dollarization over time. In Paraguay and Costa Rica, deposit dollarization initially increased in the late 1990s before beginning a downward trajectory in the 2000s. By contrast, countries with lower historical dollarization (Guatemala, Mexico, and Chile) exhibit a gradual increase in deposit dollarization. On average, deposit dollarization declined over the full sample period, but remained elevated, standing at approximately 40 percent by the end of 2019.

The last key variables in our dataset are inflation-targeting adoption and exchange rate regimes. Since inflation targeting has been shown to play a central role in shaping the ERPT (see Taylor, 2000), Appendix 2a reports the timing of inflation-targeting adoption for each country in our sample, while Appendix 2b presents the average proportion of inflation-targeting adoption. Most countries adopted an inflation-targeting regime in the early 2000s, with Costa Rica being the last to do so in 2017. Exchange rate regimes have also been shown to influence the ERPT, primarily through their impact on exchange rate volatility. Appendix 3 displays the de facto exchange rate regimes for each country[8]. Notably, no country in our sample maintains a fully floating regime throughout the period; only Mexico and Uruguay exhibit short episodes of free float in 1995. This pattern is consistent with the well-known "fear of floating" documented by Calvo and Reinhart (2002).

[7] While deposit dollarization measures the share of deposits held in any foreign currency, most of these deposits are denominated in USD.

[8] We rely on the *Coarse* classification of exchange rate regimes proposed by Ilzetski et al. (2019).

FIG. 1. Deposit dollarization in Latin America



Note: Percentage share of banking deposits in foreign currencies. Data source: Latin Macro Watch, IMF.

3. Methodology

Our empirical framework relies on the Local Projections (LP) method introduced by Jordà (2005). Local Projections are widely used in recent macroeconometric literature to produce impulse response functions, thanks to their high flexibility, simplicity, and robustness to model misspecification. In particular, LPs are preferred to VARs when lag structures vary across units in a panel, as they do not impose a common autoregressive process (Jorda and Taylor, 2025; Carrière-Swallow et al., 2025). We estimate our baseline specification using Ordinary Least Squares (OLS). However, a well-known feature of LP is that residuals are correlated across horizons *h*, since the dependent variable overlaps. While it does not affect single-horizon estimates, it complicates the construction of confidence bands for further horizons (see Montiel Olea and Plagborg-Moller, 2021). To address this concern, we clustered standard errors at the country level using the Driscoll-Kraay clustered SE for small panels, proposed by Driscoll and Kraay (1998)[9]. As shown by Hoechle (2008), Driscoll-Kraay SE are robust to heteroscedasticity and general forms of cross-sectional and serial correlation[10]. This

[9] Much of the literature follows this strategy when it comes to Local Projections (Jorda and Taylor, 2025).
[10] We use the *xtscc* command for Stata.

way of estimating SE assumes sufficiently large T. In addition, Driscoll-Kraay SE is built to account for unbalanced panels, which is the case of our dataset.

However, as also discussed in Hoechle (2008), the number of clusters (N) should not be too small (>20) to ensure stable standard error estimates. Since our sample only has 7 countries, the resulting confidence intervals should be interpreted with caution. To address this concern, we conduct a robustness exercise in Section 5. Specifically, we compute clustered standard errors and perform inference using the wild cluster bootstrap-t procedure for very small samples[11]. This latter procedure provides the most parsimonious and conservative standard errors.

We estimate the Exchange Rate Pass-Through (ERPT) to consumer prices for our sample of countries using the following local projections specification:

$$p_{i,t+h} - p_{i,t} = \beta_h \Delta USD_{i,t} + \sigma_h \Delta gdp_{i,t} + \sum_{l=0}^{L} \gamma_h^l \Delta PPI_{i,t-l} + \sum_{l=1}^{L} (\alpha_h^l \Delta USD_{i,t-l} + \emptyset_h^l \Delta p_{i,t-l}) + \mu_i + \delta_t + \varepsilon_{i,t+h} \quad (1)$$

Where $p_{i,t}$ is the natural logarithm of the consumer price index (CPI) for country i at month t, such that $p_{t+h} - p_t$ represents the cumulative change in consumer prices over the horizon h. Δ denotes the first difference operator. $USD_{i,t}$ is the natural logarithm of the bilateral exchange rate against the U.S. dollar, where an increase corresponds to a depreciation of the domestic currency. β_h is the coefficient of interest, capturing the cumulative response of consumer prices at horizon h to a one-percent depreciation of the exchange rate.

The control variables follow Burstein and Gopinath (2014). $PPI_{i,t}$ is the natural logarithm of the import-weighted foreign CPI, proxying for foreign production costs. $gdp_{i,t}$ is the natural logarithm of real GDP, proxying for the output gap. We include L=12 lags of inflation (Δp_i), exchange rate changes (ΔUSD_i), and foreign-CPI changes (ΔPPI_i) to control for dynamic effects. μ_i are country fixed effects, controlling for time-invariant characteristics (e.g., differences in average inflation level, average openness to trade, etc.). δ_t are time fixed effects, controlling for common shocks (e.g., US monetary policy shocks, energy and food price shocks, EMBI shocks, etc.). $\varepsilon_{i,t+h}$ is the error term.

3.1 Endogeneity

A key challenge common to studies estimating the ERPT is the potential endogeneity between inflation and the exchange rate, as inflation also drives currency movements. However, identifying a suitable instrument to address this endogeneity is often difficult. As a result, much of the ERPT literature focuses on estimating the *gross* effect of currency movements on

[11] We use the *wildbootstrap* command for Stata.

inflation, where *gross* refers to the overall impact of an exchange rate change, including any subsequent adjustments in both inflation and exchange rate (see Aron et al. 2014 for a review).

In this section, we emphasize two mitigating factors for this endogeneity issue. First, Rey (2015) discusses the emergence of a global financial cycle driven by US monetary policy, influencing capital flows and asset prices worldwide. She shows that exchange rate movements in developing and emerging countries are mostly driven by external shocks, such as commodity price shocks and US monetary policy shocks, and less by domestic variables (i.e., domestic inflation). While both inflation and the exchange rate can still react endogenously to those external shocks, the time fixed effects should capture the main global shocks (i.e., US monetary policy shocks, oil and commodity price shocks).

With the time fixed effects capturing for global shocks, the remaining variation in the exchange rate could still be endogenous. However, a second mitigating factor for exchange rate endogeneity in our particular setting is the exchange rate regime. As discussed by Caselli et al. (2019), in pegged regimes, exchange rate fluctuations are mostly driven by the peg or changes in the peg, but less by other variables such as inflation. In our dataset, the most frequent regime is the intermediate one, requiring the exchange rate to evolve within a crawling band/peg (see Ilzetzki et al. 2019), while freely floating exchange rate regimes account for only a small portion of the data. Exchange rate fluctuations are largely predetermined by the band/peg rules rather than reacting to domestic inflation. Therefore, while this does not fully eliminate exchange rate endogeneity, it reduces it to an acceptable level.

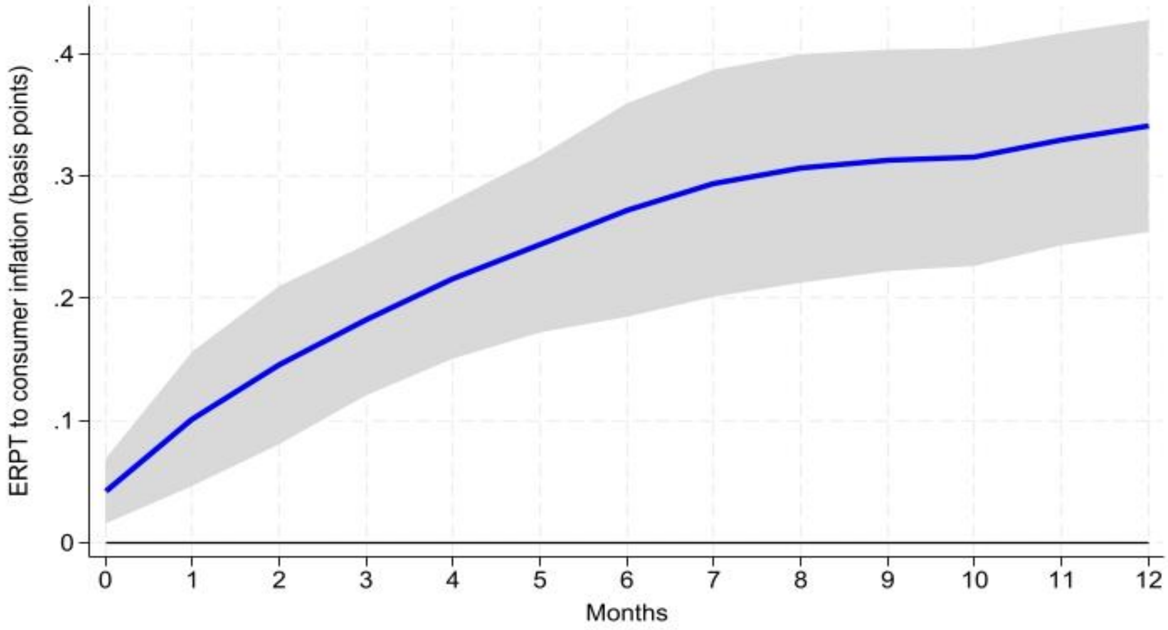
3.2 Time variation in ERPT

Figure 2 reports the impulse responses associated with the coefficient β_h from equation (1) for horizons up to *h=12* months. The estimated ERPT accumulates gradually over time, reaching nearly 35 percent after one year, after which it tends to flatten.

To assess the variation of ERPT over time, Figure 3 plots the estimate of β_h (for *h=12 months*) on a 10-year rolling window[12]. Figure 4 extends this exercise to shorter horizons, looking at β_h for *h=6* months (left panel), and for *h=3* months (right panel). For each of the three horizons we consider, the rolling-window estimates reveal a pronounced decline in ERPT over time. The one-year-ahead ERPT fell from 42 percent in 1995–2004 to 16 percent in 2010–2019. The six-month and three-month estimates exhibit similar dynamics, dropping from 36 and 24 percent, respectively, to 13 and 9 percent over the same period. These results confirm a sizable and persistent reduction in ERPT in Latin America over the past decades.

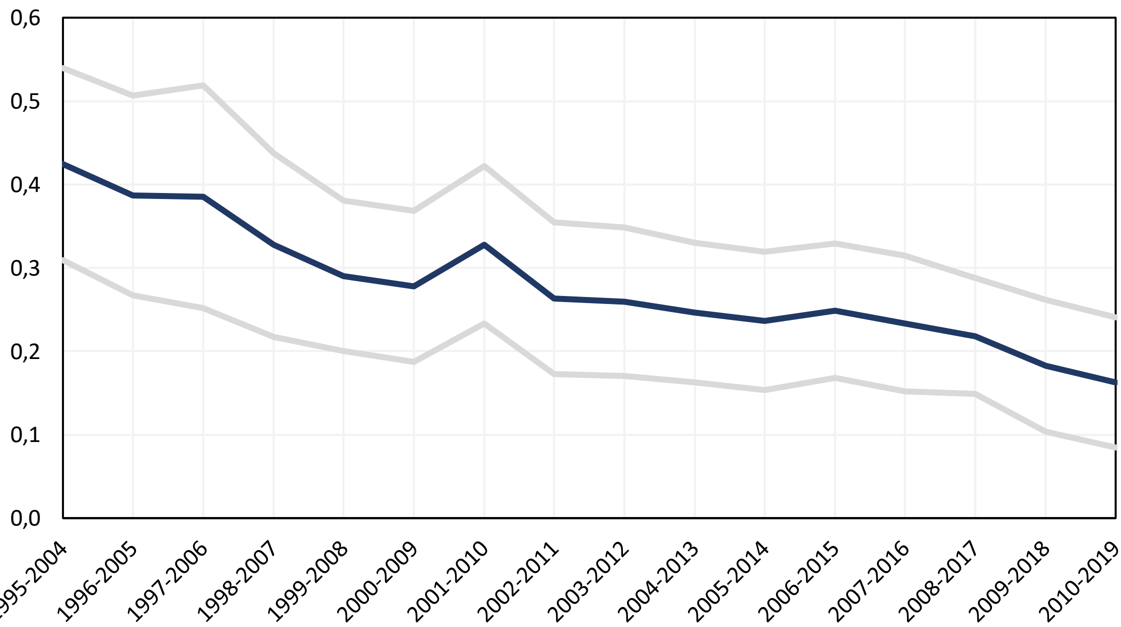
[12] The first rolling window includes the period 1995m1-2004m12. Each rolling window starts at the first month of each year. The last rolling window is 2010m1-2019m12.

FIG. 2. Average ERPT



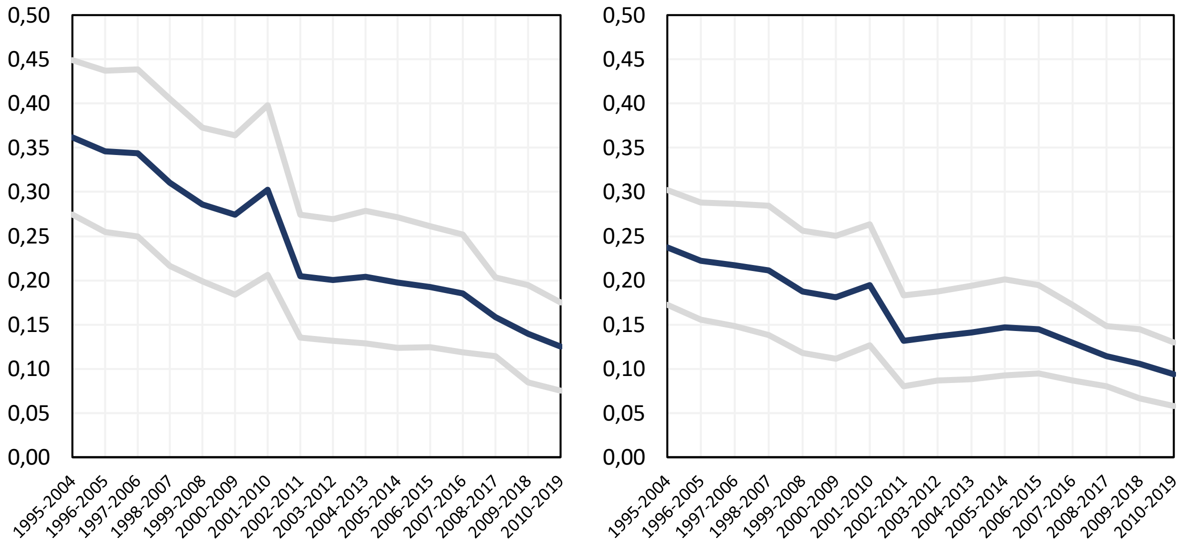
Note: Point estimates are based on Equation (1), estimated using Local Projections with time and country fixed effects. Standard errors are clustered at the country level and computed using the Driscoll-Kraay standard errors. Grey areas represent the 95% confidence interval level.

FIG. 3. One year ahead ERPT



Note: Point estimates are based on Equation (1), using Local Projections over a 10-year rolling window with time and country fixed effects. Standard errors are clustered at the country level and computed using the Driscoll-Kraay standard errors. Grey lines represent the 95% confidence interval level.

FIG. 4. Six-month and three-month ahead ERPTs



Note: Point estimates are based on coefficients β_h from equation (1), with *h*=6 for the left-hand figure and *h*=3 for the right-hand figure. Estimated over a 10-year rolling window with time and country fixed effects. Standard errors are clustered at the country level and computed using the Driscoll-Kraay standard errors. The grey lines represent the 95% confidence interval.

Appendices 4 and 5 extend these exercises using alternative window lengths to verify that our results are not driven by the choice of the rolling window. Using a 5-year window (Appendix 4), the one-year-ahead ERPT (*h=12 months*) declines from 37 percent in 1994–1998 to 7 percent in 2015–2019. Using a 7-year window (Appendix 5), the corresponding estimates fall from 45 percent in 1994–1998 to 17 percent in 2015–2019. Although the absolute levels of ERPT vary slightly with the window length, all estimates consistently document a marked decline in ERPT.

Finally, to examine whether the observed decline in ERPT is driven by any individual country, Appendix 6 re-estimates equation (1) in a 10-year rolling window, using a leave-one-out procedure. We consistently find a decline in ERPT over time across all leave-one-out estimations, suggesting that no single country is driving the estimates.

4. Effect of deposit dollarization

After documenting the decline in ERPT, we estimate the contribution of deposit dollarization to this decline. To do so, we use the following regression:

$$p_{i,t+h} - p_{i,t} = \beta_h \Delta USD_{i,t} + \omega_h(\Delta USD_{i,t} * Doll_{i,t-1}) + \sum_{l=0}^{L} (\gamma_h^l \Delta PPI_{i,t-l} + \pi_h^l Doll_{i,t-l})$$
$$+ \sum_{l=1}^{L} (\alpha_h^l \Delta USD_{i,t-l} + \emptyset_h^l \Delta p_{i,t-l}) + \sigma_h \Delta gdp_{i,t} + \vartheta_h(\Delta USD_{i,t} * X_{i,t}) + \tau_h X_{i,t} \qquad (2)$$
$$+ \mu_i + \delta_t + \varepsilon_{i,t+h}$$

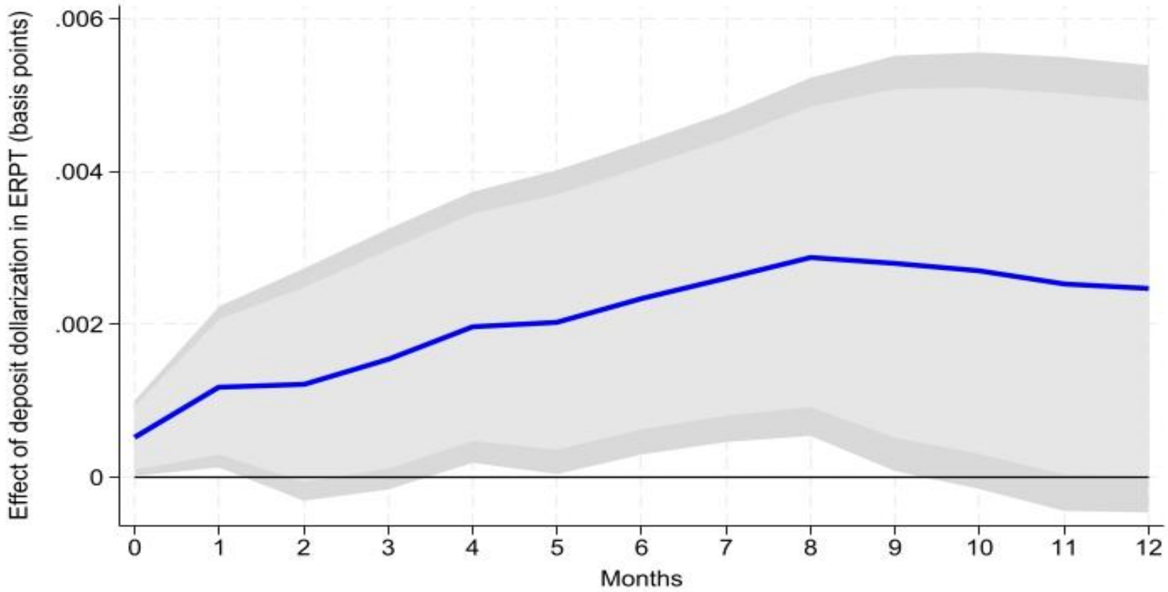
Where $Doll_{i,t-1}$ is the lagged share of bank deposits in foreign currency. Its interaction with $\Delta USD_{i,t}$ captures the effect of deposit dollarization on the ERPT (ω_h). $X_{i,t}$ is a vector of additional controls, including a dummy for inflation-targeting adoption and a measure of de facto exchange rate regimes. These variables are also interacted with $\Delta USD_{i,t}$ to capture their influence on the ERPT. We include L=12 lags of deposit dollarization ($Doll_i$), inflation (Δp_i), exchange rate changes (ΔUSD_i), and foreign-CPI changes (ΔPPI_i) to control for dynamic effects. μ_i are country fixed effects, δ_t are time fixed effects and ε_i is the error term. Country fixed effects should absorb the impact of all time-invariant structural characteristics that may influence the ERPT, such as long-run openness to trade and currency of invoicing of trade (Boz et al. 2025).

A challenge specific to our research question is the potential endogeneity of deposit dollarization. The literature on drivers of dollarization suggests that lower ERPT (or lower inflation) can decrease deposit dollarization[13]. Intuitively, when the ERPT declines, agents anticipate a weaker inflation response to currency depreciation, prompting a switch back to the local currency. To partially address potential endogeneity concerns, we use the lagged value of $Doll_i$ instead of its contemporaneous value. Moreover, despite the observed decline in ERPT, deposit dollarization remains elevated —averaging 40% in 2019 across our sample— suggesting that deposit dollarization is relatively insensitive to these changes. In fact, as argued by Levi-Yeyati (2006), among others, dollarization is largely driven by historical values of inflation and ERPT, rather than their short-term fluctuation. In this context, concerns about reverse causality between the ERPT and dollarization appear limited.

Figure 5 plots the impulse response associated with ω_h, for horizons up to *h=12* months. The estimated coefficients are positive and statistically significant at the 95% level for most of the horizons. At the one-year horizon, a one-percentage-point increase in deposit dollarization is associated with a rise in ERPT by approximately 0.25 percentage points, significant at the 90% level. Quantitatively, for a country such as Peru—where deposit dollarization declined from roughly 80 percent in the early 2000s to around 40 percent by 2019—this estimate implies a reduction in ERPT of about 10 percentage points. These results indicate that changes in deposit dollarization seem to have contributed to the decline in ERPT in Latin America.

[13] See the portfolio model in Levi-Yeyati et al. (2006) and Ize et al. (2005).

FIG. 5. Average effect of deposit dollarization on the ERPT



Note: Point estimates are based on Equation (2), estimated using Local Projections with time and country fixed effects. Standard errors are clustered at the country level and computed using the Driscoll-Kraay standard errors. Light and dark grey areas represent the 90% and 95% confidence intervals, respectively.

Table 2 reports the estimated coefficients for all contemporaneous variables (except for inflation, included at *t-1*), at horizon *h=12* months only, for different specifications. To benchmark the magnitude of the dollarization effect, we compare it with the impact of inflation targeting, a key determinant of ERPT highlighted in the literature (e.g., Taylor 2000). In our preferred specification (a), adopting an inflation-targeting regime reduces the one-year-ahead ERPT by roughly 20 percentage points—about twice the effect attributable to the observed decline in Peruvian dollarization over 2000–2019. Hence, while the effects of deposit dollarization are statistically significant at the 90% level, they are only economically meaningful for large shifts in dollarization. Given the still-elevated levels of dollarization in our panel of countries (35% on average in 2019), further de-dollarization could significantly dampen the ERPT.

Looking at other specifications, the coefficient significance for $\Delta logUSD_{i,t} * Doll_{i,t}$ remains stable, except when controls for the exchange-rate regime are excluded (specification b). Since substantial changes in exchange rate regimes have occurred in Latin America over the last two decades (see Appendix 3), removing these controls leads to important omitted-variable bias. Regarding the coefficient size for $\Delta logUSD_{i,t} * Doll_{i,t}$, it increases when controls for inflation-targeting adoption are excluded (specification c). Incorporating controls for the exchange-rate regime and inflation-targeting is therefore important to credibly isolate the contribution of deposit dollarization to the ERPT. Finally, the coefficient for $\Delta logUSD_{i,t} * Doll_{i,t}$ also increases when trade-weighted foreign CPI or when time fixed effects are excluded (specifications d and f). Our coefficient of interest, therefore captures the impact of these controls, implying an overestimation of deposit dollarization effects when they are omitted.

Table. 2. Estimates from equation (2)

	Dependent variable: $\boldsymbol{p_{i,t+h} - p_{i,t}}$ for $h = 12$					
	(a)	**(b)**	**(c)**	**(d)**	**(e)**	**(f)**
$\boldsymbol{\Delta P_{i,t-1}}$	-0.02	0.21	0.004	0.11	-0.017	0.19
$\boldsymbol{\Delta USD_{i,t}}$	0.29**	0.39***	0.065	0.30**	0.28**	0.32**
$\boldsymbol{\Delta gdp_{i,t}}$	-0.18**	-0.12	-0.17**	-0.19**		0.06
$\boldsymbol{\Delta PPI_{i,t}}$	2.51**	2.75**	2.61**		2.54**	2.28***
$\boldsymbol{Doll_{i,t}}$	-0.0005	-0.0003	-0.0007	-0.0004	-0.0005	-0.002
$\boldsymbol{\Delta USD_{i,t} * Doll_{i,t-1}}$	0.0024*	0.0017	0.004***	0.003*	0.0026*	0.0034*
$\boldsymbol{IT_{i,t}}$	-0.007	-0.002		-0.008	-0.007	-0.02***
$\boldsymbol{\Delta USD_{i,t} * IT_{i,t}}$	-0.20*	-0.24**		-0.23**	-0.20*	-0.32**
$\boldsymbol{Regime_{i,t}}$	yes	no	yes	yes	yes	yes
$\boldsymbol{\Delta USD_{i,t} * Regime_{i,t}}$	yes	no	yes	yes	yes	yes
Time FE	yes	yes	yes	yes	yes	no
Country FE	yes	yes	yes	yes	yes	yes
Observations	1617	1617	1617	1617	1617	1617
R-squared	0.67	0.62	0.66	0.65	0.67	0.39

Note: Estimates based on Equation (2), using Local Projections. Standard errors are clustered at the country level using Driscoll-Kraay SE. $Regime_{i,t}$ is the measure of de facto exchange rate regime included in the vector $X_{i,t}$. Significance levels : *** $p < 0.01$, ** $p < 0.05$, * $p < 0.10$.

To assess whether our results are driven by some countries in particular, we re-estimate equation (2) using a leave-one-out procedure. The magnitude of the estimated coefficients for $\Delta USD_{i,t} * Doll_{i,t-1}$ remains relatively stable across subsamples, ranging from 0.18 to 0.35 percentage points. Chile tends to amplify the estimated effect: excluding it lowers the one-year ahead (*h=12 months*) to 0.18 percentage points. By contrast, Uruguay attenuates the estimates. Dropping Uruguay increases the coefficient to 0.50 percentage points. While the point estimate remains positive, the confidence intervals vary depending on the country excluded. In particular, excluding Mexico or Chile substantially widens confidence intervals. One possible explanation is that these countries display a greater variability in the relevant variables and include more extreme observations. Overall, the leave-one-out procedure suggests that the positive relationship between deposit dollarization and the ERPT is not driven by a single country, although statistical precision is sensitive to the sample composition.

Finally, we replicate this exercise, controlling for different lags. Since our original model uses 12 lags (of $\Delta logCPI$, $\Delta logUSD$, $\Delta logCPIx$, and $doll$), we run a model including 18 lags, and another one including 24 lags. The estimates and confidence intervals are similar to the 12 lag model (see Appendix 7 and Appendix 8).

5. Robustness checks

5.2 Wild cluster bootstrap standard errors

As a robustness check, we conduct inference using the wild cluster bootstrap-t procedure of Cameron et al. (2008) and Roodman et al. (2019)[14]. This approach yields more reliable standard errors for samples with a very small number of clusters (N<20). We re-estimate equation (2) using the wild bootstrap-t procedure. Since the inclusion of time fixed effects for the full period in the wild bootstrap framework is highly demanding in degrees of freedom, we instead include a restricted set of period-specific dummy variables corresponding to major global shocks that impacted Latin America. Specifically, we control for the Russian financial crisis (1998m1-1999m12), the Argentinian crisis (2001m1-2002m12), the Great Financial Crisis (2008m1-2009m12), and the 2014-2015 commodity price shock (2014m1-2015m12). Given the potential influence of oil prices on inflation dynamics, we include an additional control for global oil prices.

Table 3 reports the coefficients for all the variables at time *t* (except for lagged inflation, taken at time *t*-1), at horizon *h*=12 months only, with wild bootstrap clustered SE.

Table. 3. Equation (2) with wild bootstrap SE

	Dependent variable: $\boldsymbol{p_{i,t+h}} - \boldsymbol{p_{i,t}}$ for h = 12					
	(a)	**(b)**	**(c)**	**(d)**	**(e)**	**(f)**
$\boldsymbol{\Delta P_{i,t-1}}$	0.18	0.4	0.28	0.36	0.18	0.19
$\boldsymbol{\Delta USD_{i,t}}$	0.28	0.38**	-0.03	0.34	0.28	0.30
$\boldsymbol{\Delta gdp_{i,t}}$	0.035	0.08	0.043	0.035		0.04
$\boldsymbol{\Delta PPI_{i,t}}$	1.92***	1.98***	1.94***		1.92***	1.86***
$\boldsymbol{OIL_t}$	0.01	0.01	0.01	0.03**	0.01	0.02
$\boldsymbol{Doll_{i,t}}$	-0.001**	-0.001***	-0.002*	-0.001**	-0.0013**	-0.002**
$\boldsymbol{\Delta USD_{i,t} * Doll_{i,t}}$	0.003*	0.002	0.006*	0.003**	0.003*	0.003*
$\boldsymbol{IT_{i,t}}$	-0.02***	-0.013		-0.019***	-0.02***	-0.02
$\boldsymbol{\Delta USD_{i,t} * IT_{i,t}}$	-0.28**	-0.34**		-0.29**	-0.28**	-0.29**
$\boldsymbol{Regime_{i,t}}$	yes	no	yes	yes	yes	yes
$\boldsymbol{\Delta USD_{i,t} * Regime_{i,t}}$	yes	no	yes	yes	yes	yes
Time FE	yes	yes	yes	yes	yes	no
Country FE	yes	yes	yes	yes	yes	yes
Observations	1617	1617	1617	1617	1617	1617

Note: Estimates based on Equation (2), using Local Projections. Standard errors are clustered at the country level and computed using the wild cluster bootstrap. $Regime_{i,t}$ is the measure of de facto exchange rate regime included in the vector $X_{i,t}$. OIL_t is the global oil price. Significance levels : *** p < 0.01, ** p < 0.05, * p < 0.10.

[14] We use the *wildbootstrap* command for Stata.

While the wild bootstrap clustered SE provides the most cautious confidence intervals, the effect of deposit dollarization on the ERPT after one year remains significant at the 90% level. Moreover, the coefficient for $\Delta logUSD_t * Doll_{t-1}$ is slightly larger than in the baseline results: a one-percentage-point increase in deposit dollarization is associated with a 0.3 percentage points rise in ERPT (specification a). This difference likely reflects the fact that the wild bootstrap estimation excludes full-period time fixed effects.

6. Conclusion

The decline in Exchange Rate Pass-Through (ERPT) to consumer prices in both developing and advanced countries during the 2000s has been widely documented. In Latin America, this decline has coincided with a progressive reduction in dollarization. This paper examines whether and by how much dollarization, measured by the share of deposits in foreign currency, contributed to the fall in ERPT. Two stylized facts motivate this focus. First, deposit dollarization has been persistently high in Latin America since the 1990s (Levi-Yeyati, 2021), raising concerns about its implications for key macroeconomic outcomes. Second, average deposit dollarization in the region has declined steadily since the early 2000s (Levi-Yeyati 2021), coinciding with the documented fall in ERPT.

We argue that deposit dollarization influences the ERPT through two main channels. First, it proxies for the share of priced indexed to the US dollar; as this share increases, a larger fraction of consumer prices becomes sensitive to exchange rate movements, mechanically raising the ERPT. Second, deposit dollarization reflects the extent of financial dollarization: a higher share of dollar-denominated assets and liabilities weakens monetary policy transmission and credibility, indirectly increasing the ERPT.

Using monthly data for seven Latin American economies over 1995–2019, we document a substantial decline in ERPT—from roughly 40 percent in 1995–2004 to about 15 percent in 2014–2019. We then show that lower deposit dollarization is associated with a significant decline in ERPT: a one-percentage-point reduction in dollarization lowers the ERPT by 0.25 percentage points. These results are robust to controls for foreign producer prices, past domestic inflation, economic growth, inflation-targeting adoption, exchange rate regimes, and country and time fixed effects. For a country such as Peru, the fall in deposit dollarization from about 80 percent in the early 2000s to 40 percent in 2019 could explain a reduction in ERPT of roughly 10 percentage points (after 1 year). For comparison, adopting an inflation-targeting regime reduces the ERPT by roughly 20 percentage points (after 1 year). While deposit dollarization has economically meaningful effects only for large shifts, the still-elevated levels of dollarization in the region suggest that further de-dollarization could substantially dampen the ERPT. Overall, these results underscore the central role of dollarization in shaping ERPT dynamics and highlight the macroeconomic benefits of continued de-dollarization efforts.

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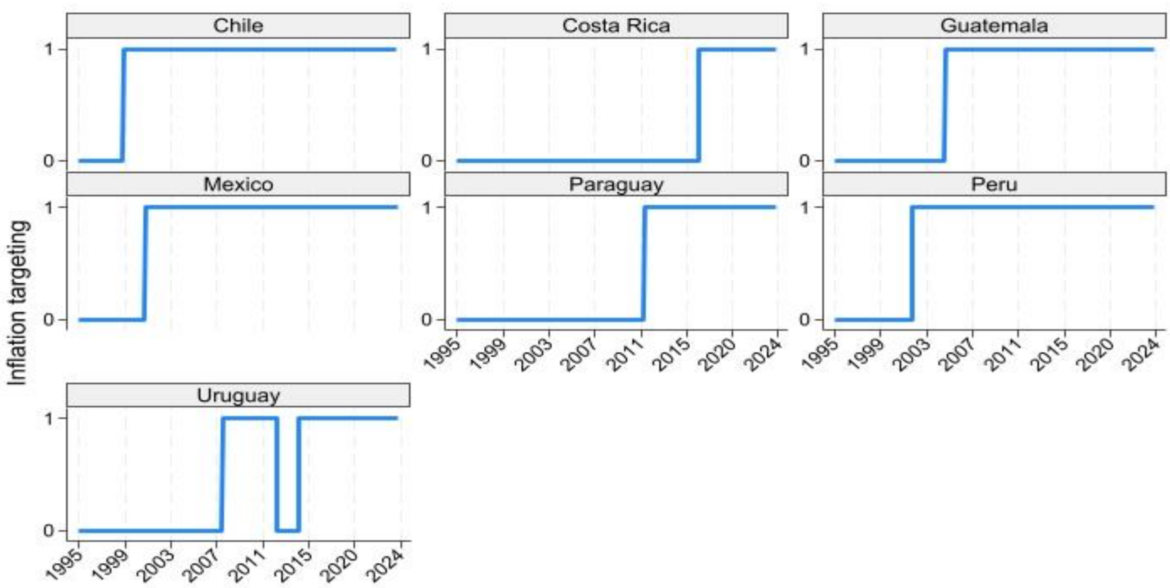
8. Appendix

1. Variables list and sources

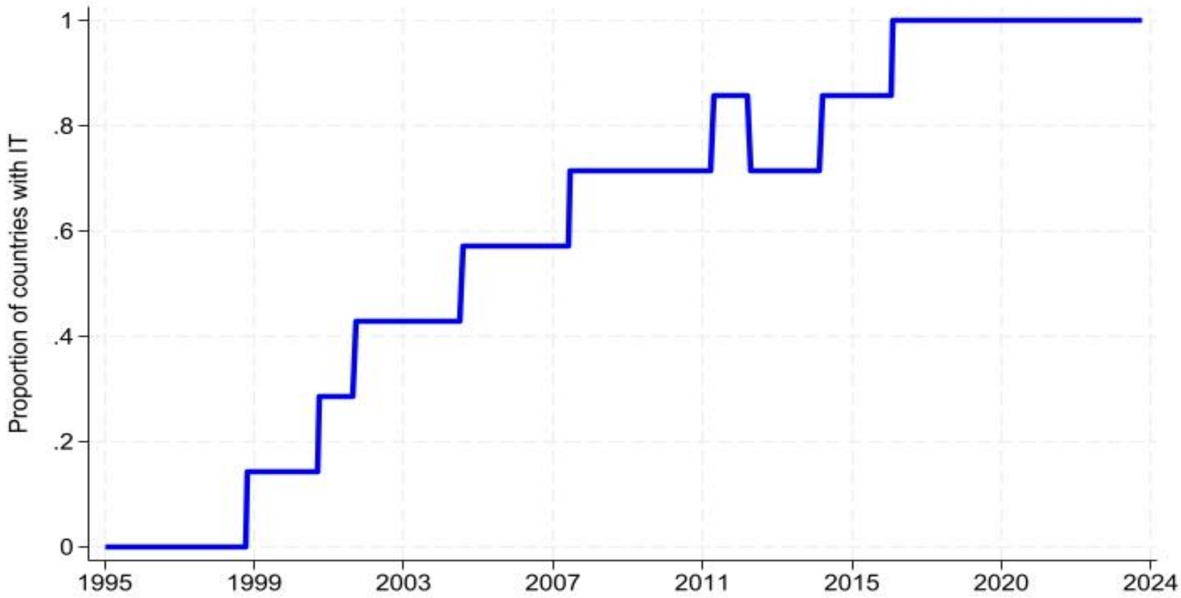
Variables	**Data sources**
Consumer price index (CPI)	Latin Macro Watch, IMF database
Bilateral exchange rate with the US dollar	Latin Macro Watch, IMF database
Deposit dollarization (share in total deposits)	Latin Macro Watch, IMF database
Real GDP	Latin Macro Watch, IMF database
Real effective exchange rate	Darvas (2021)
Nominal effective exchange rate	Darvas (2021)
Inflation targeting (binary)	De Gregorio (2019), central-bank websites
De facto exchange rate regimes	Ilzetzki et al. (2019)
Oil prices index (Brent) in US dollars	Intercontinental Exchange (ICE)

2a. Inflation-targeting adoption



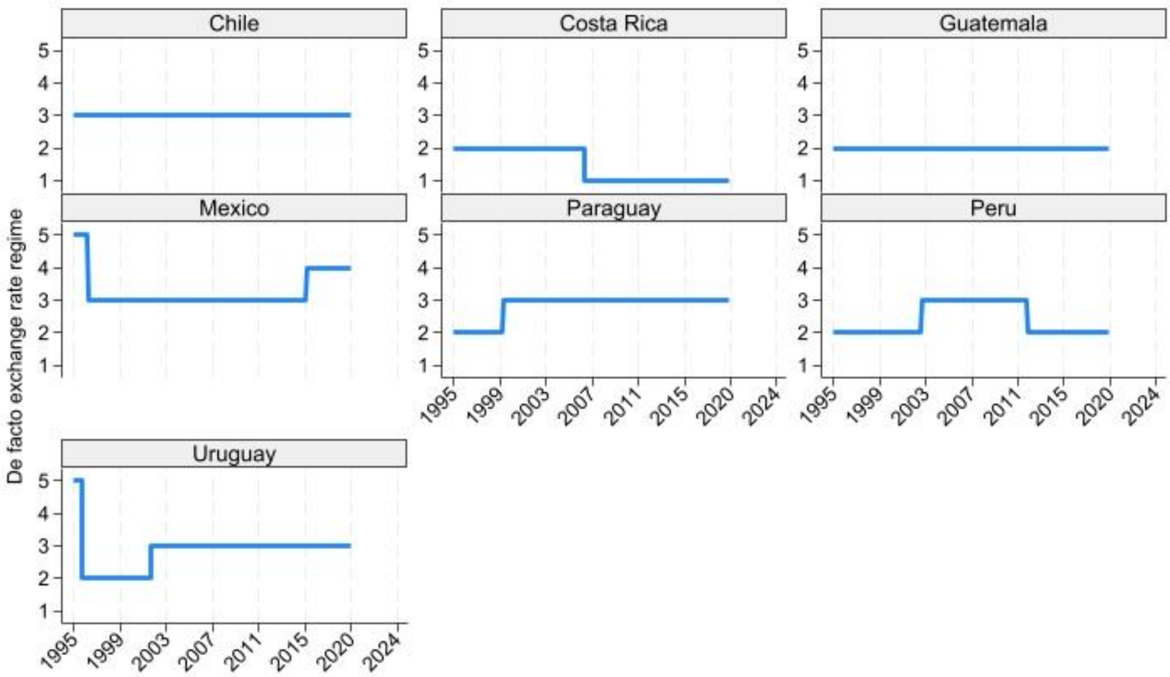
Note: Inflation targeting adoption. The binary variable takes 1 when the country has an official inflation target. Data source: Central banks' websites and De Gregorio (2019).

2b. Proportion of inflation-targeting adoption



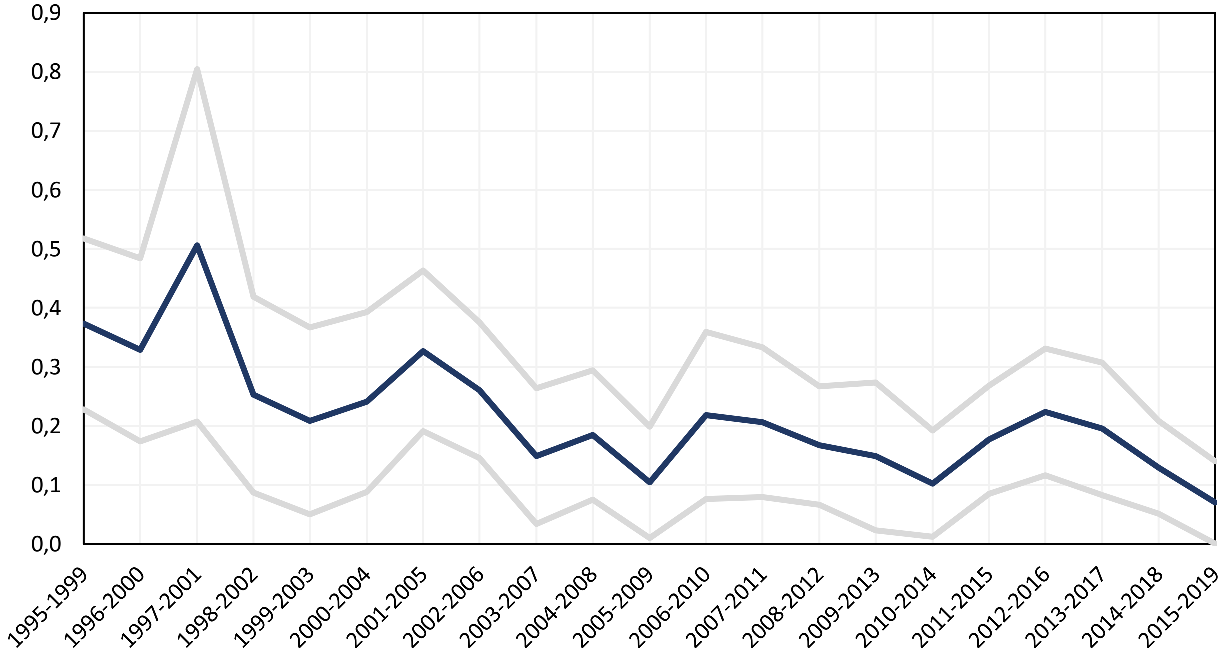
Note: Inflation targeting adoption. Average proportion of countries with an inflation target. The variable takes 1 when all countries have an official inflation target. Data source: Central banks websites and De Gregorio (2019).

3. De facto exchange rate regimes



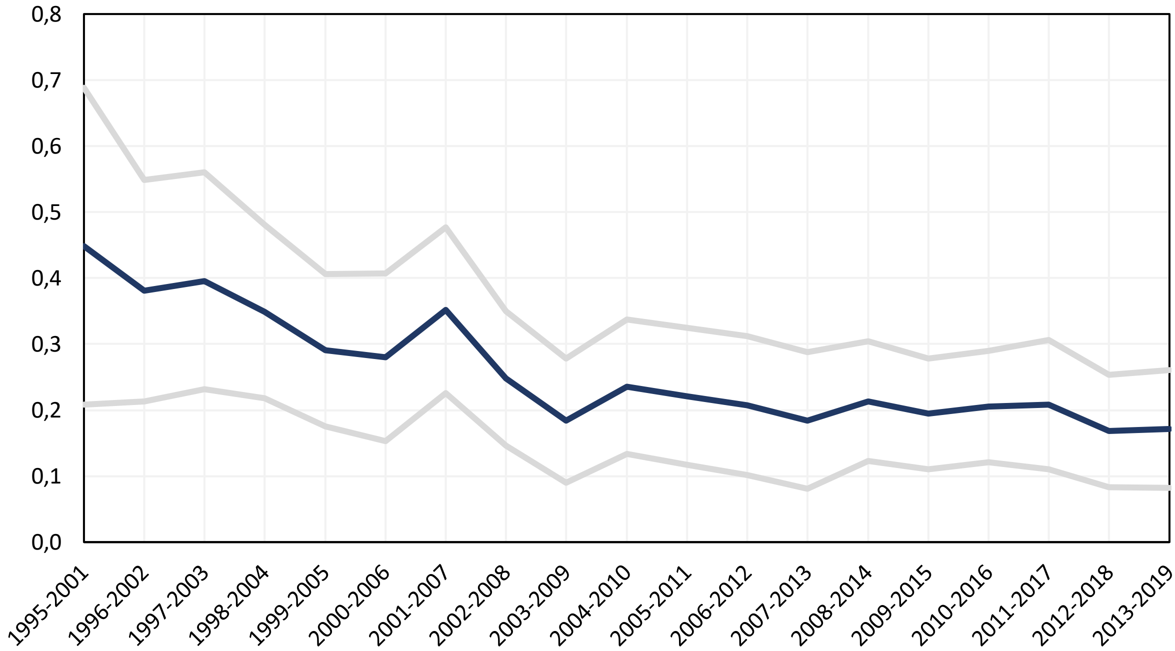
Note: De facto exchange rate regimes. *Coarse* classification where 1 denotes the least flexible arrangement (a fixed or pegged regime), and 5 denotes the most flexible exchange-rate arrangement. Data source: Ilzetzki et al. (2019).

4. One year ahead ERPT – 5 years rolling window



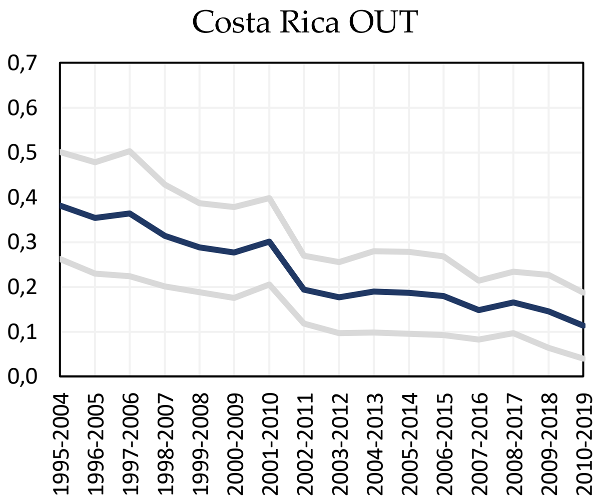
Note: Point estimates are based on coefficients β_h from equation (1), with h=12. Estimated over a 5-year rolling window with time and country fixed effects. Standard errors are clustered at the country level and computed using the Driscoll-Kraay standard errors. The grey lines represent the 95% confidence interval.

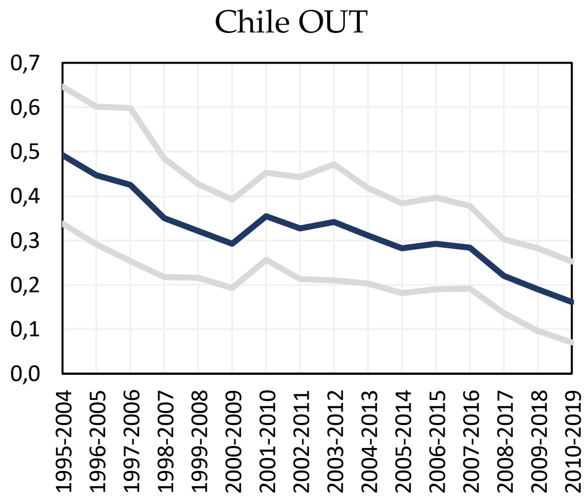
5. One year ahead ERPT – 7 years rolling window

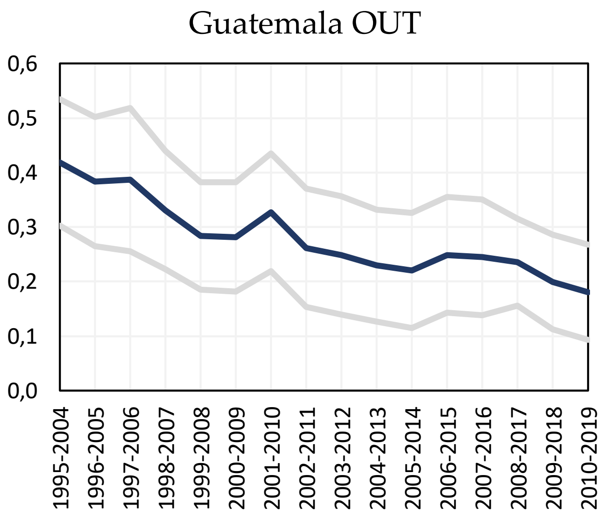


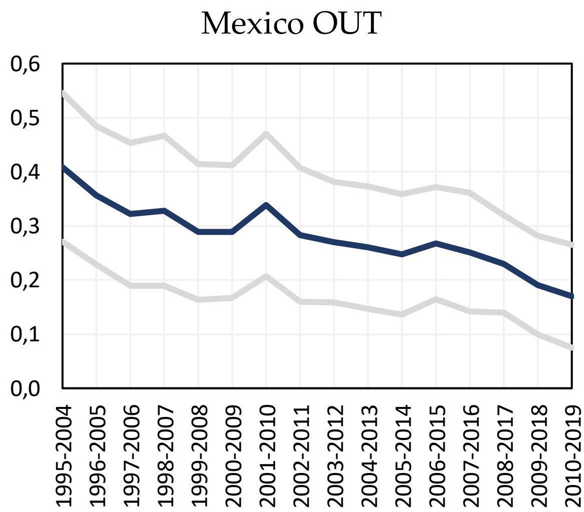
Note: Point estimates are based on coefficients β_h from equation (1), with h=12. Estimated over a 7-year rolling window with time and country fixed effects. Standard errors are clustered at the country level and computed using the Driscoll-Kraay standard errors. The grey lines represent the 95% confidence interval.

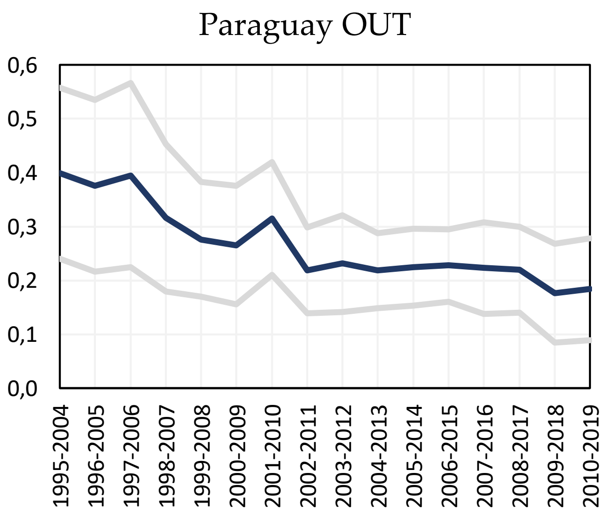
6. One year ahead ERPT – leave-one-out procedure

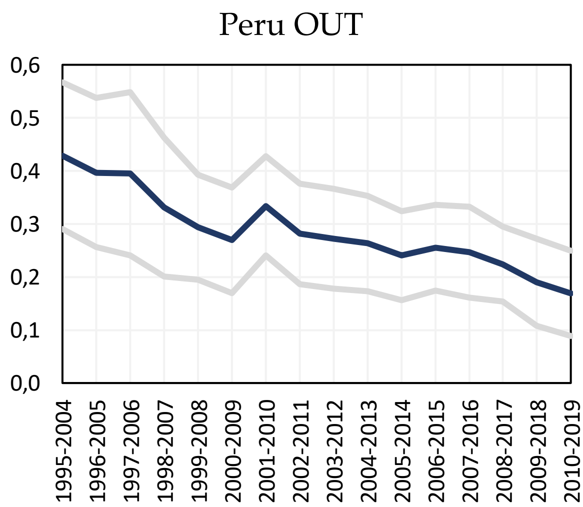


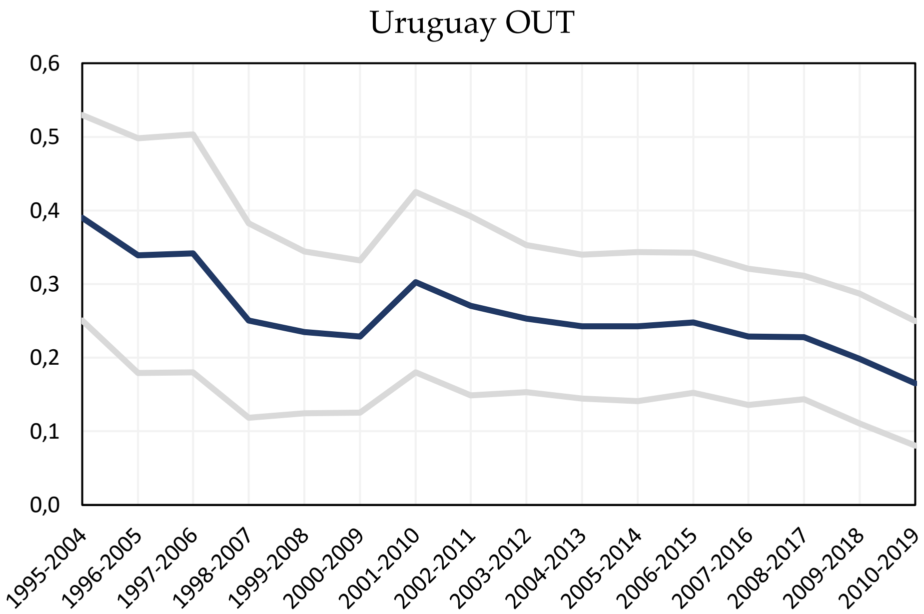






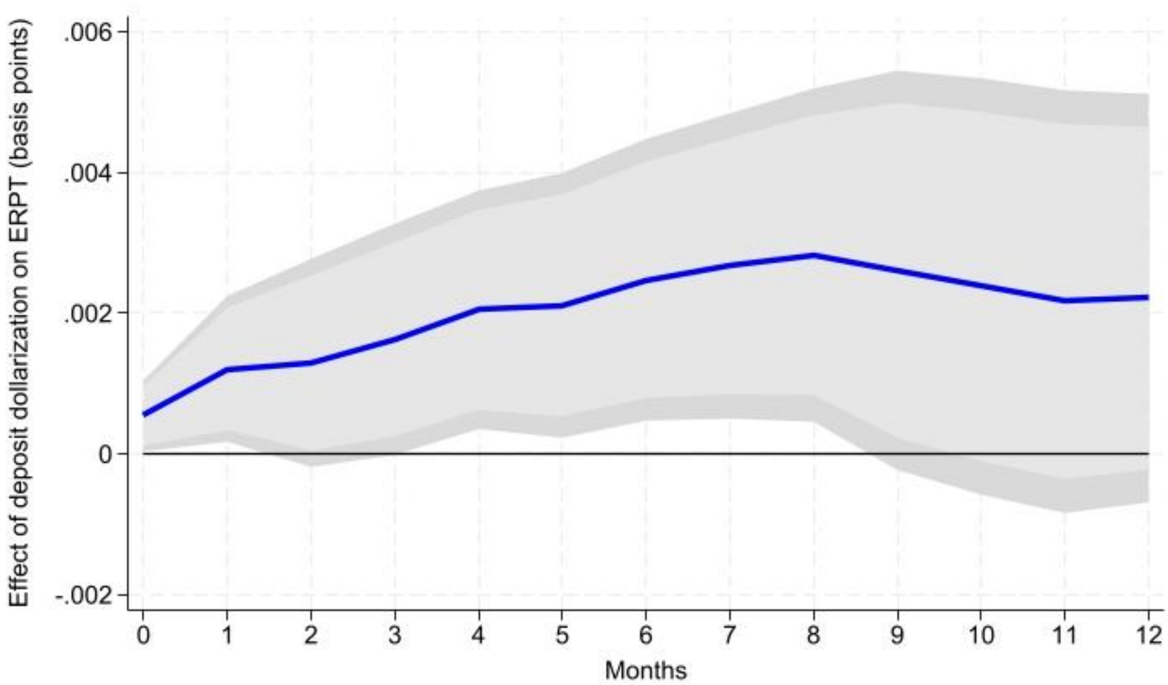






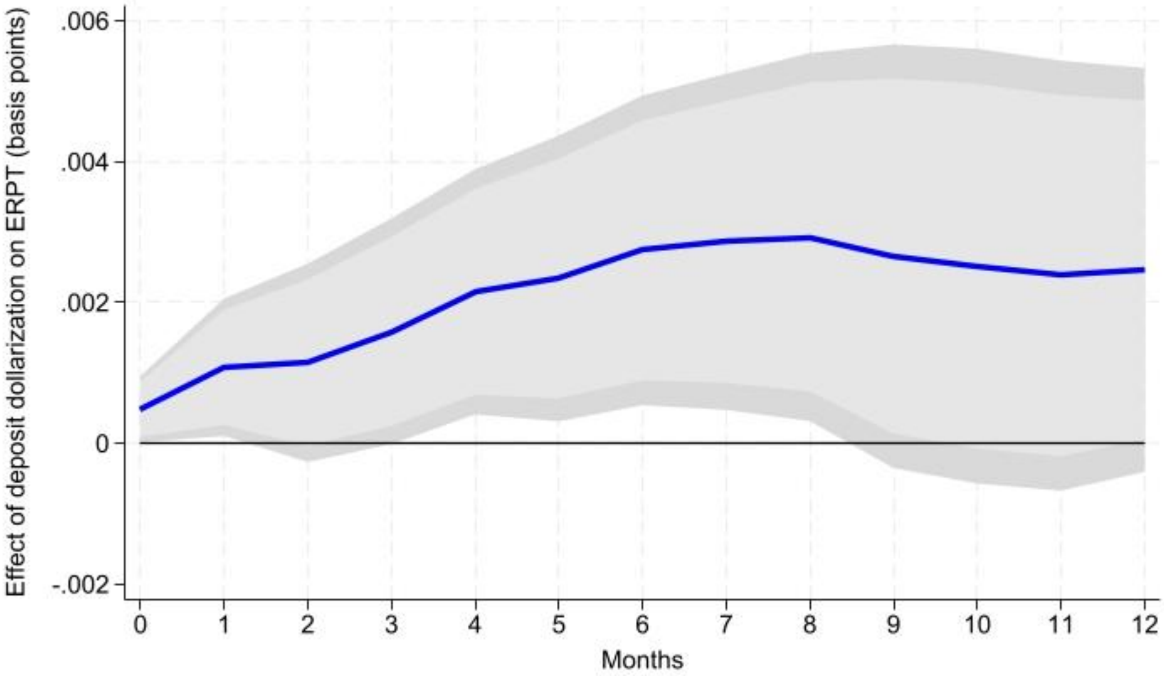
Note: Point estimates are based on coefficients β_h from equation (1), with h=12, using a leave-one-out procedure. Estimated over a 10-year rolling window with time and country fixed effects. Standard errors are clustered at the country level and computed using the Driscoll-Kraay standard errors. The grey lines represent the 95% confidence interval.

7. Effect of deposit dollarization on ERPT (Driscoll-Kraay SE) – 18 lags



Note: Point estimates are based on Equation (2), estimated using Local Projections with time and country fixed effects. Standard errors are clustered at the country level and computed using the Driscoll-Kraay standard errors. Light and dark grey areas represent the 90% and 95% confidence intervals, respectively.

8. Effect of deposit dollarization on ERPT (Driscoll-Kraay SE) – 24 lags



Note: Point estimates are based on Equation (2), estimated using Local Projections with time and country fixed effects. Standard errors are clustered at the country level and computed using the Driscoll-Kraay standard errors. Light and dark grey areas represent the 90% and 95% confidence intervals, respectively.

INSTITUT DE RECHERCHE
ÉCONOMIQUES ET SOCIALES

Place Montesquieu 3
1348 Louvain-la-Neuve

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