Referee Report

Exchange Rate Pass-through and Inflation Dynamics in Tunisia: A Markov Switching Approach (Manuscript Number: 774)

While this paper addresses a topic of general interest, it is at its current state not publishable and requires additional work. Drafting needs to be significantly improved so that readers can grasp more easily the paper's message, implication and value added relative to the existing literature. I would recommend the author to incorporate the below comments, improve the drafting and resubmit the paper.

COMMENTS:

1. The econometric analysis rests on a Markov switching approach. Such a regime switching methodology is convenient to tackle the questions the authors raise. The authors distinguish between two specific techniques, namely a fixed transition probability (FTP) approach and a time-varying transition probability (TVTP) approach. The FTP approach reveals less flexibility as it does not allow for time-varying transition probabilities. I would thus suggest that the authors concentrate more on the TVTP approach and less on the FTP approach.

2. Some studies show that the stability of pass-through into disaggregated import prices appears more robust than the stability into aggregate import price series. This apparent stability helps provide a deeper understanding of the sources of fluctuations in pass-through into aggregate import prices. Indeed, the aggregate import price series could potentially evolve over time because of changes in the composition of the import bundles, rather than because of changes in the underlying pass-through elasticities on component products. It would thus be interesting to formally test for the stability of these pass-through elasticities by country.

3. In Section 5 of the paper the authors aim to identify macroeconomic and policy-related variables that explain inflation dynamics in Tunisia over the investigated sample period. To this end, the authors focus on four specific economic fundamentals including an interest rate, industrial production, exports and imports. There are other variables that could have an impact on inflation dynamics but are strangely omitted from the analysis. For example, to what extent can changes in monetary aggregates and the output-gap affect inflation dynamics? These issues merit further investigation.

4. Finally, the paper would strongly benefit from a cross-country perspective. In particular, it would be interesting to see how the authors' results hold up when examining countries with similar macroeconomic structures (albeit with a slightly different monetary policy set-up), such as Algeria and Morocco.