

Monetary Policy

The relevance of current research for policymakers research priorities in LICs

Christopher Adam – Oxford and IGC

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Policy objectives and structural characteristics

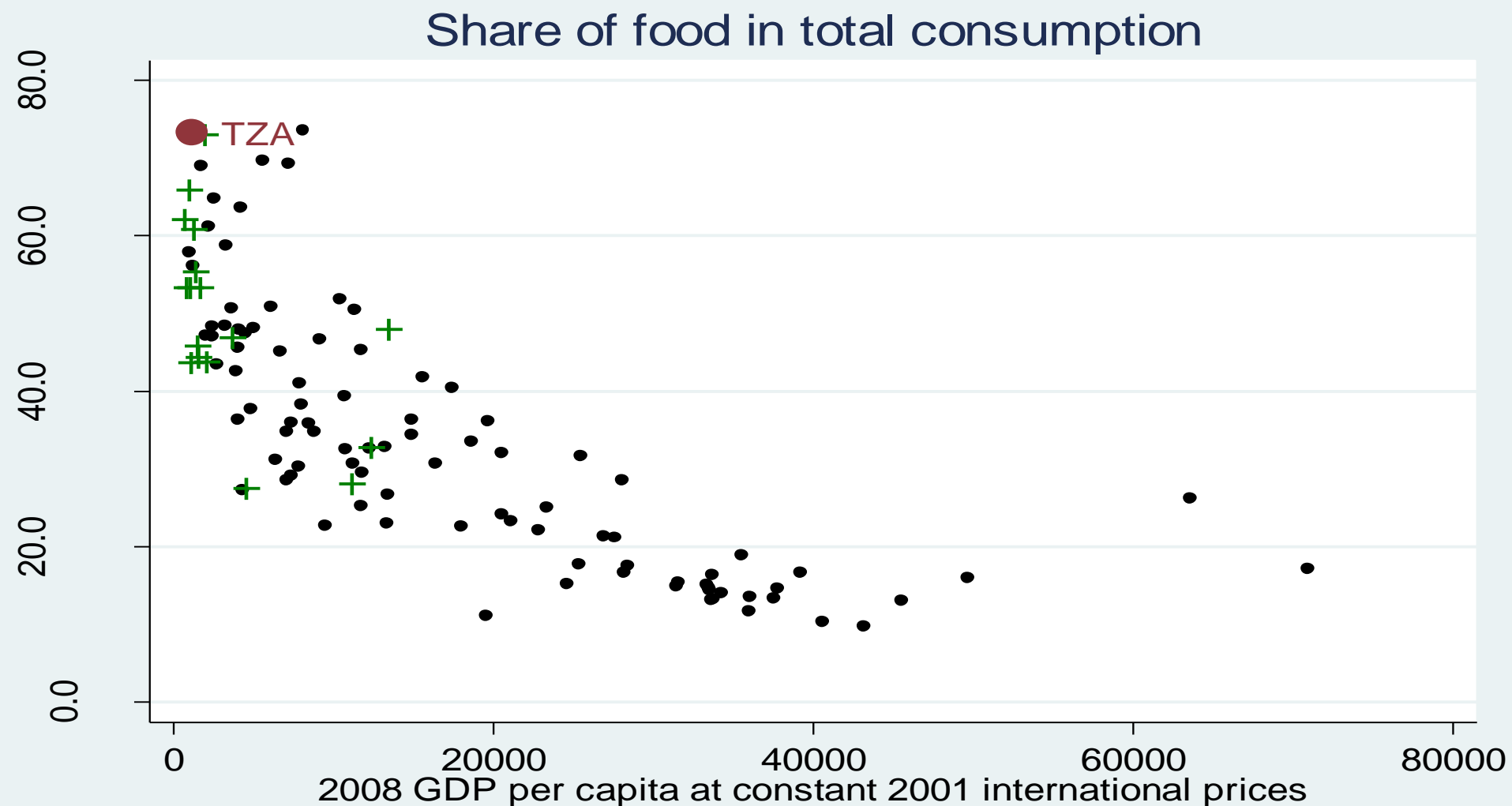
- FP at best acyclical...
- Central banks see themselves playing a major role in stabilization...and often beyond... even though case for monetary activism in face of huge uncertainty not obvious.
- **‘Conventional’ policy objectives and ‘unconventional’ structural characteristics**

High frequency decisions require ‘real time’ models

Policy objectives and structural characteristics

- **‘Conventional’ monetary policy objectives**
 - Price stability with first-order concerns about exchange rate and output volatility
- **‘Unconventional’ structural characteristics**
 - High share of agriculture / primary sectors in production => primacy of supply-side shocks
 - High food / fuel share in consumption sector
 - De jure open capital accounts; de facto only partially open
 - Latent fiscal dominance with major fiscal-aid interactions
 - Extensive market segmentation and monopoly (in goods and assets)
 - (Very) incomplete and thin financial markets => limited instruments
 - Significant technological innovation (e.g. mobile-phone banking)

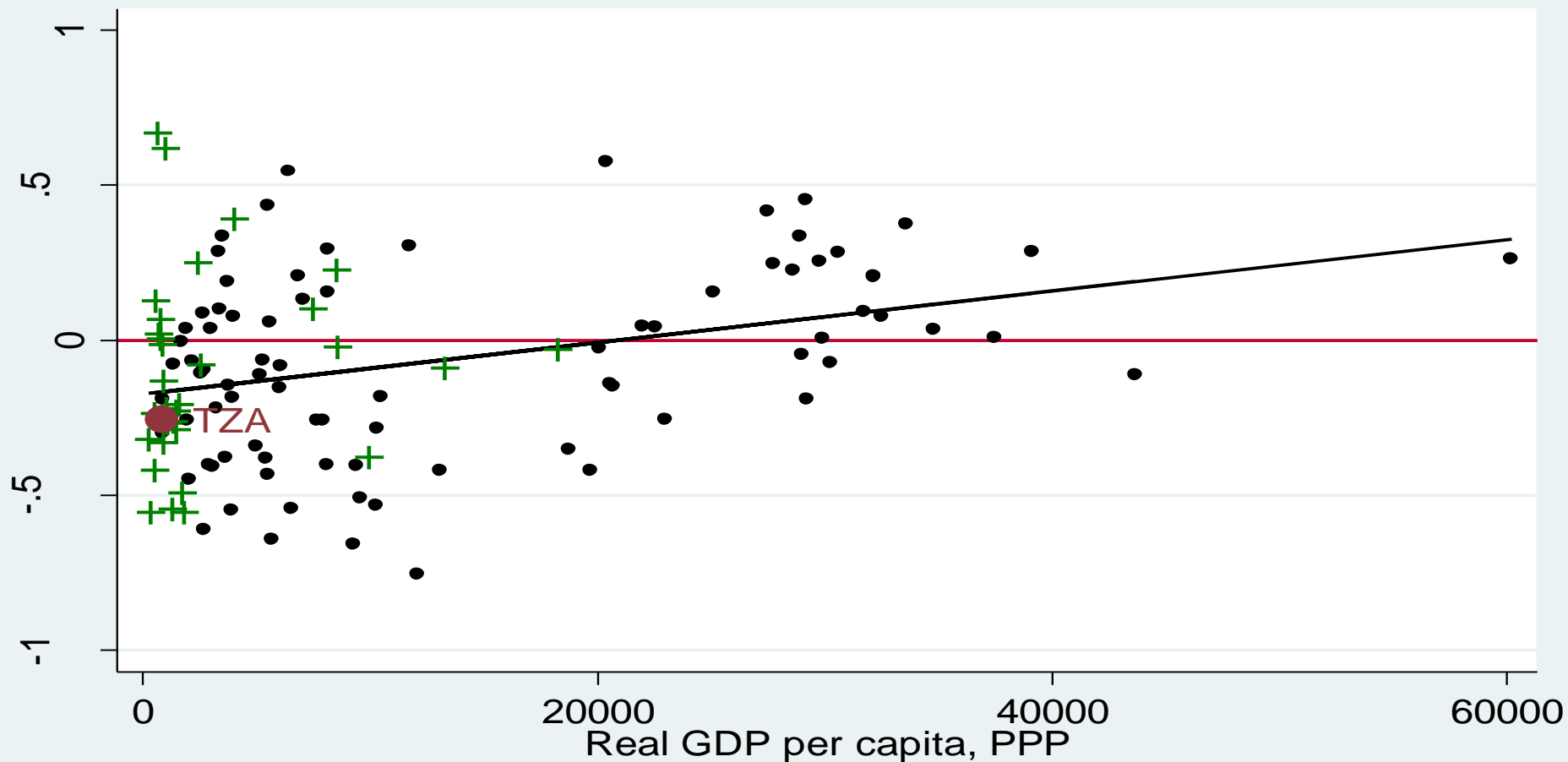
Fig 1: Food share in consumption is large



Source: USDA Economic Research Service

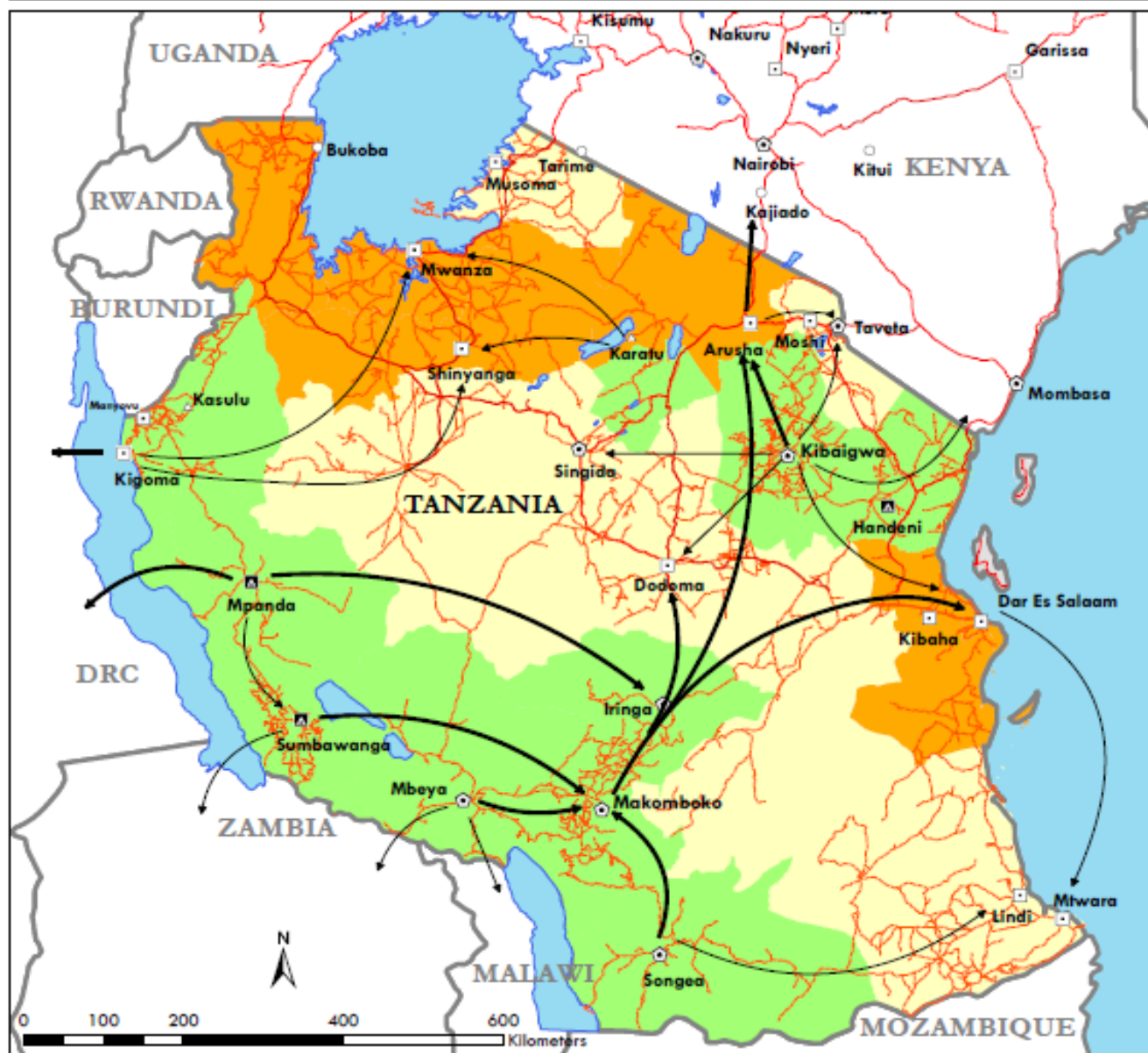
Fig 2: supply-side shocks dominate

Correlation between real GDP and inflation



HP-filtered variables. All countries with 17 or more yrs of data starting in 1990.

Source: Adam et al. (2010).



Key Market Centres

- Retail
- Wholesale
- △ Assembly
- ◼ Retail & Wholesale
- ⊠ Assembly & Wholesale
- ⊞ Assembly, Wholesale & Retail

All Season Maize

- Major Production/Surplus
- Minor Deficit
- Major Deficit

Trade Flow

- Large Flow
- Small Flow

Road Types

- Main Roads
- Minor Roads
- Railways

Districts

Lakes



Produced 24 Jul 2008

Research demands from African Central Banks

Priority areas

- Data (real economy / leading indicators / expectations)
- Empirical models for: (i) inflation forecasting; (ii) MTM
- Analytical modelling:
not 'what to do' but 'how to think about what to do'

Big questions on choice of monetary regimes / nominal anchor still up for grabs (e.g. EAC monetary union).

Empirical: some IGC self-promotion

- Ongoing work on structural models of inflation in agrarian economies (for Tanzania MPC)
- Ongoing work on financial architecture and MTM (Montiel et al)
 - Classic channels relatively weak
 - Credit channel also weak b/c imperfect competition
 - Understanding / characterizing CB reaction functions
 - Proxies for AD with no real economy data

Horses for courses: operational quantitative models for LIC central banks

- If there is a ‘model’ it is an IMF financial programming framework (a legacy of tough stabilization debates of 1990s) .
- **What next: a basic wish-list**
 - ‘shocks are on the supply side’ => two/three sector Salter-Swan structure
 - Credit constrained consumers / firms (w non-homothetic prefs?)
 - Partially open capital account (sudden stops...official and private)
 - Monopolistic banks
 - Balance sheet instruments (‘MP *with* the LM curve’)
 - Central role for seigniorage
 - Fiscal instruments (e.g public and private storage)
- **But its not a blank slate!**
 - Berg Karan Laxton (2006); Adam, Buffie, O’Connell (2009); Berg, Portillo et al (2010..); Anand and Prasad (2010)