Implications of Food Subsistence for Monetary Policy and Inflation

Portillo et al., (2016) introduce subsistence requirements in food consumption into a simple new-Keynesian model with flexible food and sticky non-food prices, and study how the endogenous structural transformation that results from subsistence affects the dynamics of the economy, the design of monetary policy, and the properties of inflation at different levels of development. The work derives a welfare-based loss function for the monetary authority and show that optimal policy calls for complete (in some cases near complete) stabilization of sticky-price non-food inflation, despite the presence of a food subsistence threshold. Results show subsistence amplifies the welfare losses of policy mistakes, however, raising the stakes for monetary policy at earlier stages of development.

Inflation Targeting and Exchange Rate Management in Less Developed Countries

Airaudo et al., (2016) analyze coordination of monetary and exchange rate policy in a two-sector model of a small open economy featuring imperfect substitution between domestic and foreign financial assets. The central finding is that management of the exchange rate greatly enhances the efficacy of inflation targeting. In a flexible exchange rate system, inflation targeting incurs a high risk of indeterminacy where macroeconomic fluctuations can be driven by self-fulfilling expectations. Moreover, small inflation shocks may escalate into much larger increases in inflation ex post. Both problems disappear when the central bank leans heavily against the wind in a managed float.

Macro Dimensions of Public-Private Partnerships

Buffie et al., (2016) investigate the repercussions of public-private partnerships (P3s) vs. own-investment (OI) in a dynamic general equilibrium model featuring private capital accumulation and involuntary unemployment with efficiency wages. Typically, P3s cost more but produce higher-quality infrastructure and boast a better on-time completion record than OI; consequently, they are comparatively more effective in reducing under-investment in private capital, under-investment in infrastructure, unemployment, and poverty. The asymmetric impact on macro externalities raises the social return in the P3 2 - 9 percentage points relative to the social return to OI, depending on whether the

Workshop and Toolkit on Macro-Fiscal Issues in Natural Resource Management

In partnership with East AFRITAC, a five-day workshop was held at the Bank of Tanzania to train government officials from Kenya, Tanzania, and Uganda on macro-fiscal issues in natural resource management. The course introduced tools to assess the macroeconomic impacts of scaling up public investment in the face of a resource windfall. Officials from the Ministries of Finance and Energy as well as central banks attended. Participants were introduced to the DIG and DIGNAR toolkits, which provide a user-friendly Excel-based interface for simulating policy scenarios. The toolkits require no prior knowledge of Matlab and allow users to provide country-specific calibration, specify exogenous shocks, and choose customized plots and variables.

Current account norms in natural resource rich and capital scarce economies

Published in the Journal of Development Economics, Araujo et al., (2016) develop a neoclassical model with private and public investment and several pervasive features in resource-rich developing countries (RRDCs), including absorptive capacity constraints, inefficiencies in investment, borrowing constraints, and capital scarcity. The model is used to study the role of investment and these frictions in shaping the current account dynamics under windfalls. Since consumption and investment decisions are optimal, the model also serves to analyze current account norms (benchmarks). The model was applied to the Economic and Monetary Community of Central Africa, and the results can be used to inform external sustainability analyses in RRDCs.

Too much and too fast? Public investment scaling-up and absorptive capacity

A recent trend in several low-income developing countries has been a rapid scaling-up of public investment. It is argued that in the presence of limited absorptive capacity, countries are not able – in terms of skills, institutions, and management – to translate additional public investment into sustained output growth. Presbitero (2016), published in the Journal of Development Economics, tests for the presence of absorptive capacity constraints using a large dataset of World Bank investment projects, approved between 1970 and 2007 in 80 countries. Results indicate that projects undertaken in periods of public investment scaling-up are less likely to be successful,
externalities operate singly or in combination and on whether P3 enjoys an advantage in speed of construction.

Evolution of Bilateral Capital Flows to Developing Countries at Intensive and Extensive Margin

Araujo et al. (2016) examines capital flows and their evolution at intensive and extensive margins by presenting a parsimonious theoretical account that is then mapped into an econometric framework to allow two-tier decisions and cross-sectional dependence. Results indicate that market entry costs affect investment decisions pertinent to the LICs, consistently with the static theory. However, persistence in extensive margin eliminates this effect once dynamics are allowed.

Although this effect is relatively small, especially in poor and capital scarce countries. Moreover, this effect is unrelated to large aid flows and donor fragmentation.

Challenges Facing Commodity-dependent LICs

Prakash Loungani gave a presentation at an United Nations General Assembly high-level dialogue on fiscal and structural challenges facing commodity-dependent developing economies. The presentation discussed the growth performance and prospects for commodity-dependent LICs vs. more diversified economies. The diversification toolkit developed under the IMF-DFID project was used to illustrate possible growth strategies for commodity-dependent economies. The presentation also discussed the near-term adjustment needed in some commodity-dependent LICs. Using the DIGNAR model developed under the project, the likely counter-productive effects of making the adjustment solely through sharp cuts in public investment were illustrated and compared with other options for fiscal adjustment.

For more information, please contact MacroResDev@imf.org. See IMF-DFID Macroeconomic Research for Development website for further details on the project.