



Macroeconomic Interrelationships and Informed Economic Policy Making

Workshop for Staff of
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Development
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Outline

- I. Refresher: Objectives of Macroeconomic Policies
- II. Macroeconomic Interrelationships: The Case of Fiscal Spending
- III. Macroeconomic Monitoring and Forecasting

Refresher:

Objectives of Macroeconomic Policies

General objectives of fiscal and monetary policies

- Promote sustainable economic growth and development
- High employment
- Macroeconomic stability:
 - ✓ Internal stability
 - ✓ External stability

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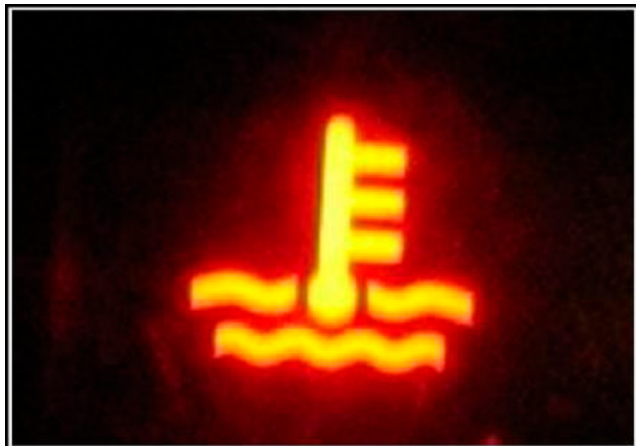
Refresher:

Objectives of Macroeconomic Policies

Internal stability

Avoiding overheating of the economy!

- Demand \approx Supply
- Output is close to potential
- Inflation pressures are moderate



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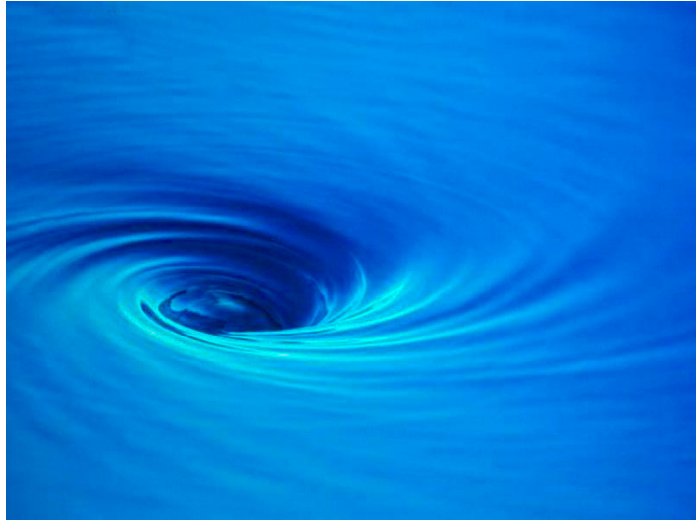
Refresher:

Objectives of Macroeconomic Policies

External stability

Avoiding large, sudden foreign exchange outflows!

- Current account roughly in balance
- Or current account deficits can be sustainably financed



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Macroeconomic Interrelationships: The Case of Fiscal Spending

Imagine you are going to scale up investment spending:

For example, you may want to build public infrastructure supporting international trade

What are the risks for macroeconomic stability?



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Macroeconomic Interrelationships: The Case of Fiscal Spending

Risks for internal stability—impact on real sector:

Large increase in investment spending raises demand for **domestic** goods and services to implement capital projects.

Is this a problem?

- If aggregate demand conditions were strong to begin with, the economy could **overheat**
- Overheating economy would lead to **rising inflation**
- **Bottlenecks** in supply response would add to inflationary pressures

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Macroeconomic Interrelationships: The Case of Fiscal Spending

Risks for internal stability—impact on monetary sector:

If increase in spending is central-bank financed, money supply can increase, further fueling inflation



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Macroeconomic Interrelationships: The Case of Fiscal Spending

Risks for internal stability—further impact on real and monetary sectors: Boom ...

Booming economy and expansion in money supply can lead to credit boom and housing bubbles



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Macroeconomic Interrelationships: The Case of Fiscal Spending

... and bust

Bursting of bubble can lead to financial sector crisis and recession



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Macroeconomic Interrelationships: The Case of Fiscal Spending

Risks for external stability—impact on BOP:

Large increase in investment spending raises demand for **imported** goods and services to implement capital projects.

Is this a problem?

- If economy has sufficient foreign exchange reserves, no.
- Otherwise, risk of currency devaluation



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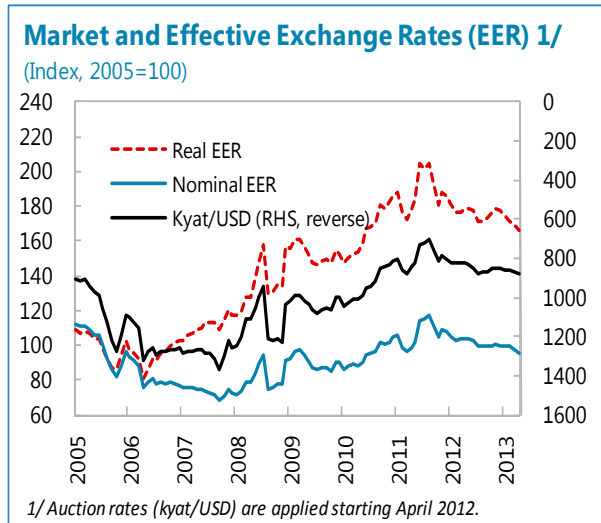
Macroeconomic Interrelationships: The Case of Fiscal Spending

Risks for external stability—impact on BOP:

Rise in inflation can lead to real appreciation of currency:

Is this a problem?

- Yes, if it leads to persistently large current account deficits that cannot be financed
- If so, need to weigh risks of actions planned for reaching objectives and consider recalibrating plans



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Macroeconomic Monitoring and Forecasting

What is to be done to avoid risks to macroeconomic stability?

Macroeconomic impact of policy measures needs to be assessed to arrive at **informed economic policy decision-making**.

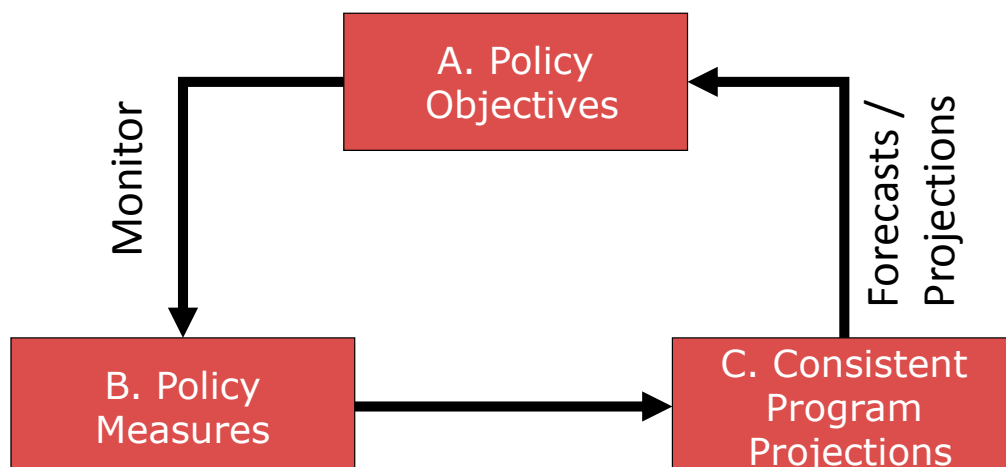
This requires:

- **Monitoring** of macroeconomic situation
- **Forecasting** of baseline without policy measures and policy scenario with measures

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Macroeconomic Monitoring and Forecasting

Macroeconomic Monitoring & Forecasting Cycle



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Macroeconomic Monitoring and Forecasting

Monitoring

Taking stock of current macroeconomic situation is first step.

This requires:

- Price statistics
- Real sector statistics (national accounts)
- BOP statistics
- Fiscal sector statistics
- Monetary statistics



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Macroeconomic Monitoring and Forecasting

Baseline projection

Next step is generating a baseline projection for **unchanged policies**.

This requires:

- Macroeconomic framework that respects accounting identities between sectors
- Understanding of key behavioral relationships



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Macroeconomic Monitoring and Forecasting

Forecasting—Consistent Program Projections

Next step: calibrating policy to reach objectives and maintain macroeconomic stability

This requires:

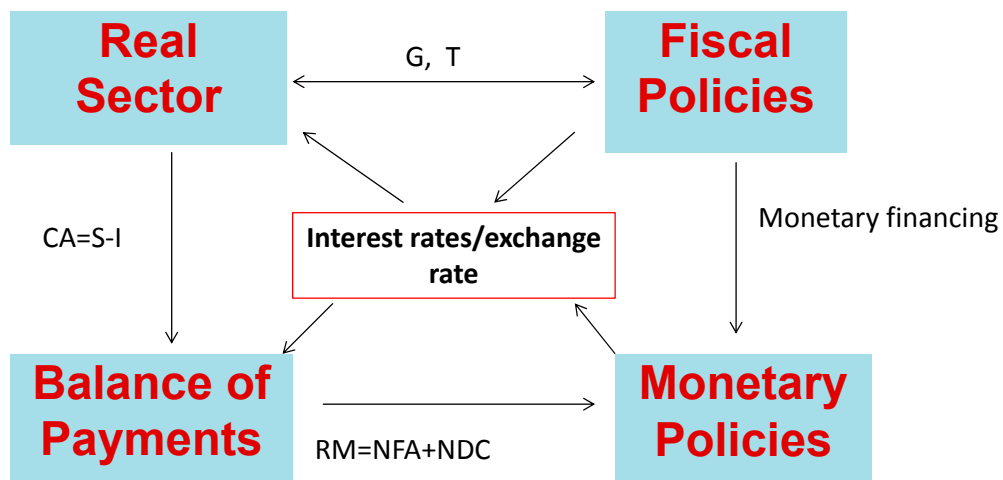
- Understanding of economic impact of policy
- Iterations



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Macroeconomic Monitoring and Forecasting

Macroeconomic framework is a very useful tool for forecasting and policy analysis!



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Macroeconomic Monitoring and Forecasting

Forecasting—Dealing with uncertainty

The challenge is not to avoid mistakes but to learn from them:

- Learning from mistakes (forecast error analysis)
- Incremental policy steps



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Macroeconomic Monitoring and Forecasting

Forecasting and macroeconomic analysis— how TA can help:

- Improving statistics (STA, TAOLAM)
- Building skills in macroeconomic analysis and forecasting (TAOLAM)

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Outlook

Next, you will hear ...

- ... how monetary policy operations work
- ... and an analysis of the budget process in Myanmar plus Treasury reforms currently underway