List of paper presentations and abstracts of the workshop on Macroeconomic Policy Research (October 4-5, 2002)

	Presenter	Title
1	Jérôme Henry	Modelling activities in the ECB
2	Claes Berg	Simple Rules for Moneary Policy? Some Swedish Experiences
3	Péter Benczúr	The behavior of the nominal exchange rate at the beginning of disinflations
4	Peter Sinclair	Should Currency Be Taxed?
5	Ágnes Csermely – Balázs Vonnák	The role of the exchange rate in the transmission mechanism in Hungary
6	Clement van de Coevering	EU Accession countries and the need for structural convergence and institutional development
7	Francz Schardax	An Early Warning Model for Currency Crises in Central and Eastern Europe
8	Axel Jochem	EU-enlargement and financial integration of CEE accession countries
9	Thomasz Chmielewski	Searching for Optimal Balance Between Nominal and Real Convergence - Case of Poland
10	András Simon – Viktor Várpalotai	Precaution and the optimal indebtedness of a country
11	Balázs Világi	Disinflation and exchange rate pass-through in the presence of sectoral asymmetries
12	David Vavra	The Czech economic transition: exploring options using a macrosectoral model
13	Viktor Kotlán	Inflation Forecasts and the Constant Interest rate Assumption

Abstracts

2.
Simple Rules for Monetary Policy?
Some Swedish Experience
by
Claes Berg, Head of Monetary Policy Department, Sveriges Riksbank
Per Jansson, Deputy Director, National Institute of Economic Research
Anders Vredin, Head of Research Department, Sveriges Riksbank

In this paper we study the role of monetary policy rules in the effective conduct of monetary policy against the background of the experience of implementing the inflation target strategy in Sweden 1993-2001. The rule communicated by the Riksbank states that if the forecast of inflation one to two years ahead is above (below) 2 per cent then the repo rate typically ought to be raised (lowered). We discuss the Swedish monetary policy rules. Comparing actual policy with simple rules may be a useful tool for such analyses, as a way to distinguish average systematic policy actions from more unusual policy behaviour. But the increased central bank transparency also offers other ways towards a better understanding of what central banks are trying to do, e.g., minutes from policy makers' meetings. This information can be used to analyse the deviations between actual policy and some simple rule. We show that monetary policy in Sweden since the introduction of the inflation target in 1993 can be described relatively well by a rule which relates the instrument rate (repo rate) to its own lag and the Riksbank's inflation forecasts. It will be shown that monetary policy as practised on most occasions adjusted the repo rate in the direction indicated by the rule.

Furthermore the monetary policy rule satisfies the Taylor principle, which implies that in the event of a sustained increase in the inflation rate by x per cent, the nominal interest rate will be raised by more than x per cent. We also discuss other considerations that have affected interest rate decisions by the Riksbank, i.e., that have caused deviations from the simple rule. Interpreting the deviations from the rules is of interest both for evaluations of monetary policy, and as a way to evaluate the standard models of monetary policy.

3.
The behavior of the nominal exchange rate at the beginning of disinflations
by
Péter Benczúr, National Bank of Hungary

A standard rational expectations model would give very strong predictions about the behavior of the nominal exchange rate at the beginning of a disinflation (monetary restriction): a substantial initial appreciation, followed by a steady depreciation. It largely conflicts the current experience of many countries, like Poland and Hungary, where an initial appreciation was not followed by any systematic depreciation. The paper tries to explore whether rational expectations can be rescued by introducing noise and parameter learning into such a model. An optimistic learning case (worse than expected inflation data every period), or the combination of a pessimistic learning case (better than expected data every period) and a declining proportional risk content of the interest rate offers a potential explanation.

5.

The role of the exchange rate in the transmission mechanism in Hungary
by
Ágnes Csermely and Balázs Vonnák, National Bank of Hungary

We present structural VAR models of the Hungarian economy to investigate the monetary transmission mechanism in Hungary during the nineties, with particular emphasis on the role of the real exchange rate as a shock absorber. As there is no consensus specification in the literature, we used several sets of identification restrictions. We show that real (supply and demand) shocks shaping the Hungarian business cycle were fairly synchronised with Europe-wide disturbances during the last decade compared to other European countries. Asymmetric demand shocks played a limited role in shaping output variability. Premium shocks dominated the developments in the real interest rate and the exchange rate. It implies that renouncing the autonomous monetary policy wouldn't incur considerable costs in terms of stabilisation.

7.

An Early Warning Model for Currency Crises in Central and Eastern Europe
by
Franz Schardax, Oesterreichische Nationalbank

This paper presents an early warning model for currency crises for a sample of quarterly data from twelve Central and Eastern European transition countries. A review of the relevant literature shows that a number of indicators contain useful information for early warning purposes when evaluated according to the signal approach. In a next step, the appropriateness of the signal appoach's underlying functional specification is investigated by means of bivariate regressions on one economic variable in different functional specifications.

On the basis of this analysis, two multivariate probit regressions with all statistically significant economic variables on a (0,1)-distributed crisis variable are estimated. For in-sample forecasts, the predictions of both model specifications proved to perform significantly better than random guesses as well as some comparable early warning models. In general, the model appears to track developments in individual countries rather well, with the exception of countries with consistently strong macroeconomic fundamentals. With respect to economic interpretations, the results of this study lend support to the hypothesis that currency crises in Central and Eastern Europe may be considered as "first-generation" types of crises.

8.
International financial market integration of the central and east European accession candidates
by
Sabine Herrmann and Axel Jochem, Deutsche Bundesbank

The paper begins by studying the existing degree of financial market integration between four selected accession candidate countries (Poland, Hungary, Czech Republic, Slovak Republic) and the euro area. It becomes evident that the international integration of the money markets still displays certain shortcomings but no longer represents a significant obstacle to EU membership. However, a more critical assessment has to be made concerning the integration of the forex markets. In the case of investment in central and eastern Europe, a significantly higher exchange rate premium is called for than within the EMS in the 1990s or between Germany and other advanced industrial countries. From the current perspective, an immediate participation in a fundamentally symmetrically designed ERM II would therefore be premature. The paper then goes on to undertake a model-theoretical and empirical search for economic policy factors which influence the international integration of the financial markets. As an initial outcome, it may be stated that the integration of the financial markets can be promoted, above all, by monetary policy being committed exclusively to price stability, a high level of competitiveness in the banking sector and liquid capital markets.

9.
Searching for Optimal Balance Between Nominal and Real Convergence – Case of Poland
by
Tomasz Chmielewski, National Bank of Poland

The aim of the paper is to assess degree of uncertainty about possible impact of the Balassa-Samuelson (BS) effect on inflation and real exchange rate in Poland. There exists vast empirical literature on the BS effect (also for EU accession countries), but the results are not clear-cut. One of the concerns for policy-makers is whether the future impact of the BS effect will be consistent with the Maastricht criteria. In the paper the degree of the BS effect in Poland is assessed using different econometric and data (e.g. classification into tradables or nontradables sector) methodologies used so far in the literature. The paper tries to answer what is the true extent to which the BS effect can influence inflation and real exchange rate in Poland and whether different estimation results are due to differences in methodologies. Other explanation may be that the problem with obtaining consistent econometric evidence mainly stems from relatively short time series available and many structural changes during transformation period. The paper is concluded with policy implications, especially possible scenarios of balancing real and nominal convergence, given assessed uncertainty about the scale of the BS effect.

10.
Precaution, Optimal External Debt and Fully non-Ricardian Behavior
by
András Simon – Viktor Várpalotai, National Bank of Hungary

The model is based on the Taylor-series approximation of Skinner (1989).It is shown that in a model of infinite horizon, uninsurable labor income risk, and precautionary bahavior stable steady state solutions of plausible magnitudes for foreign financial asset ratios exist for both creditor and debtor countries with idiosyncratic growth rates. In this case individual decisions do not necessarily add up to social optimum. However, social optimum can be enforced e.ciently through fiscal policy, because with an income-tax system behavior is fully non-Ricardian: fiscal saving appears approximately one-for one in aggregate saving.
JEL Classification: E0, E2, E6, F4, H5, H6

11.
Exchange Rate Pass-Through and Disinflation in the Presence of Asymmetric Sector Specific Shocks
by
Balázs Világi, National Bank of Hungary

We lay out a sticky price dynamic general equilibrium model in order to study the nominal exchange rate–tradable price pass-through, the tradable — non-tradable inflation gap, and the interconnection of these phenomena. We show that if prices are sticky, then asymmetric productivity shocks are not the only factors which can influence the inflation gap. But still the key determinant of the large long-run inflation gap observable in Hungary is the productivity di.erence of the two sectors. Furthermore we show that the productivity shocks which generate the inflation gap are partly responsible for the slow exchange rate pass-through in Hungary.

12.
The Czech economic transition: exploring options using a macrosectoral model
by
Frank Barry, University College Dublin
John Bradley, Economic and Social Research Institute, Dublin
Michal Kejak, CERGE-EI, Charles University, and Academy of Sciences of the Czech Republic
David Vavra, Czech National Bank

The processes that will drive the next stage of the Czech transition are likely to be similar to those promoting real convergence in the countries of the EU periphery. We draw on previous modelling research on these latter economies to construct and calibrate a small macrosectoral model of the Czech Republic. Model simulations explore some key policy issues facing CEE-country decision-makers: labour market reforms, disinflation and industrial development. Our analysis suggests that much can be learned from the experience of countries like Ireland and Portugal which have converged substantially towards EU average living standards.

Keywords: Czech Republic, Transition, Macromodel, Simulation

13.
Inflation Projections and the Constant Interest Rate Assumption
by
Viktor Kotlán and Michal Skořepa, Monetary Policy Division, Czech National Bank

Inflation targeting is a regime based to a great extent on inflation projections. Central banks, however, devote surprisingly little attention to some important issues connected with the projection. There are some non-trivial choices that need to be made on three distinct levels: construction, decision making and communication. One of the most important choices relates to the treatment of central bank's behaviour within the projection. We first differentiate between a forecast (most likely picture of the future) and a simulation (picture of the future if the behaviour of one or more agents is adjusted) and then discuss the pros and cons of using the two types of projections on the three mentioned levels.