CENTRE FOR APPLIED MACROECONOMIC ANALYSIS

ANU COLLEGE OF BUSINESS & ECONOMICS

CAMA Newsletter   **Issue 9, July 2010**

Welcome

Welcome to the ninth edition of the CAMA Newsletter, since our previous newsletter, CAMA has undergone quite substantial change. In January 2010 the Australian National University established the Research School of Economics (RSE). The RSE brings together academic staff from the School of Economics and CAMA in the ANU College of Business and Economics, and economists from the Economics Program of the Research School of Social Sciences within the ANU College of Arts and Social Sciences.

The inaugural Director of CAMA, Professor Warwick McKibbin, has taken up the position of Interim Director of the Research School of Economics and at the same time, former Deputy Director Heather Anderson moved to Monash University. These changes mean that a new leadership team has been put in place for CAMA. Effective from February this year Professor Shaun Vahey has taken on the role of Acting Director of CAMA with Dr Renée Fry as Acting Deputy Director. Leah Dunn also moved across to RSE, taking on the role of Executive Officer and in May 2010 Michelle Cowie took over as Project Officer for CAMA. Special thanks extends to Warwick, Heather and Leah for their substantial contribution to CAMA. However, they are all still an important part of the team, with both Warwick and Heather still running their respective programs.

In line with the restructuring at ANU, CAMA has moved to the Crisp Copland building on the ANU campus. Our new mailing address is on the last page of this newsletter, and on our website: http://cama.anu.edu.au/contacts.asp.

A lunch was held with the new CAMA team of staff and students at Spicy Ginger Café on the 11th May.

Other News

CAMA would like to offer its congratulations to Dr Gordon Menzies for being awarded The 2009 Kenneth J. Arrow Prizes for Junior and Senior Economists for his publication 'Inferential Expectations'. Founded in 2003, and named for renowned economist and Nobel Laureate Kenneth J. Arrow, the Arrow Prizes are awarded annually to the best articles published in bepress economics journals by junior and senior scholars.

Recent Events

Giblin Workshop

15th February 2010, University of Tasmania
Earlier in the year, CAMA jointly sponsored the Giblin Workshop with the Faculty of Business at the University of Tasmania. This workshop was held to coincide with the Giblin Lecture that the University of Tasmanian holds each year. The distinguished speaker for this year was Charles Goodhart from the London School of Economics.

CAMA Newsletter   **Issue 9, July 2010**

The Economics of Infrastructure in a Globalised World: Issued, Lessons and Future Challenges

On 18th and 19th March, a conference on the economics of infrastructure jointly hosted by The Asia Development Bank, the Brooking Institution, CAMA, The Lowy Institute for International Policy and Worley Parsons was held at The Lowy Institute for International Policy in Sydney. The aim of the conference was to bring together leading researchers from the USA, Europe, Asia and Australia to summarise the current state of knowledge, present recent advances, and map out the major challenges for infrastructure over the next 50 years. A follow up event was held at the Brookings Institution in Washington D.C. on the 10th June.

More details and a conference summary can be found at http://cama.anu.edu.au/Infrastructure_Conference.asp.

21st Annual East Asian Seminar on Economics: A Pacific Rim Perspective on the Financial Crisis

The 21st Annual East Asian Seminar on Economics was co-hosted by the National Bureau of Economic Research (NBER), the Reserve Bank of Australia (RBA) and CAMA at the Coombs Centre in Sydney on June 25-26. The Theme was A Pacific Perspective on the Financial Crisis. Several representatives from each institution and the remaining sponsoring institutions presented papers at the Seminar, including James Yetman, Jonathan Eaton and Joshua Aizenman from the NBER, Chris Kent from the RBA, and Warwick McKibbin from CAMA. Several discussants from each of these research networks were also represented. CAMA would like to thank Gordon Menzies in particular for filling a gap in the program which was well above the call of duty. Papers and the comments from the discussants can be found on the CAMA Events page and also at http://www.nber.org/~confer/2010/ease10/program.html.

Future Events

Finance and the Macroeconomy Workshop

The Finance and the Macroeconomy Program in CAMA is inviting submission of papers to a one day workshop to be held at the Australian National University on October 25, 2010 to coincide with the visit of Dr Jan Jacobs (Groningen University) and Dr Gerald Dwyer (Atlanta Federal Reserve). This will be a small workshop consisting of six papers relevant to the field. Submissions are invited from members of the Finance and the Macroeconomy Program, as well as from other interested speakers. We are also looking for discussants. Some financial support is available and early career researchers are particularly encouraged to submit their work. Submissions can be made by emailing michelle.cowie@anu.edu.au by August 31, 2010. Those interested in discussing a paper or attending the conference should also register their interest with Michelle. The final versions of the papers will be required to be sent to discussants by September 30. Please forward this email on to anyone who may be interested in attending.

The Transmission of International Shocks to Open Economies

On the 16th and 17th December 2010, The Reserve Bank of New Zealand and CAMA will host a conference on the transmission of international shocks to open economies. The recent financial crisis has illustrated the importance of the linkages that connect financial systems and economies around the globe. This conference is aimed at characterizing recent global shocks, understanding the transmission mechanism of these shocks, and identifying appropriate policy responses.

Call for papers close on the 13th August. More details about the conference can be found at http://www.rbnz.govt.nz/research/workshops/December2010/index.html.

Australasian Macroeconomics Workshop
27-28h April 2011, The University of Tasmania
The Faculty of Business at the University of Tasmania will host the Australasian Macroeconomics Workshop in April of 2011. Further details will be available shortly, but please save this date.

CAMA Newsletter   **Issue 9, July 2010**

CAMA In the Media

Links to CAMA members' media appearances can be found at http://cama.anu.edu.au/media.asp

Publication News

If you have a publication that you would like to report in this section of future editions of the newsletter, please email this to Michelle Cowie at michelle.cowie@anu.edu.au.

W McKibbin and WP Chanthapun, "Exchange Rate Regimes in the Asia-Pacific Region and the Global Financial Crisis"
http://aric.adb.org/pdf/workingpaper/WP36_Exchange_Rate_Regimes.pdf

R Fry, C Jones and C Kent, "Inflation in an Era of Relative Price Shocks"
http://www.rba.gov.au/publications/confs/2009/index.html

T Henckel and W McKibbin, "The Economics of Infrastructure in a Globalized World: Issues, Lessons and Future Challenges"
http://www.brookings.edu/~/media/Files/rc/papers/2010/0604_infrastructure_economics_mckibbin/0604_infrastructure_economics_mckibbin.pdf

F Green, **W McKibbin** and G Picker, " Confronting the Crisis of International Climate Policy"
http://www.lowyinstitute.org/Publication.asp?pid=1329

New Research Associates

We are delighted to welcome our newest Research Associate to the following CAMA programs:

Behavioural Macreconomics
Dr Justin Wolfers, Associate Professor of Business and Public Policy, The Wharton School, University of Pennsylvania.

Climate Change and Energy
Dr Paul Burke, Research Fellow, The Arndt-Corden Division of Economics, Australian National University.

Dr David Stern, Fellow, The Arndt-Corden Division of Economics, Australian National University.

Finance and the Macroeconomy
Dr Martin Berka, Senior Lecturer in Economics, School of Economics and Finance, Massey University.

Professor Gerard (Jerry) Caprio, Professor of Economics and Chair, Centre for Development Economics, Williams College.

Macroeconomic Policy Frameworks
Associate Professor Christoph Thoenissen, Associate Professor, School of Economics and Finance, Victoria University of Wellington.

Program TBA
Dr Francesco Ravazzolo, Researcher, Norges Bank (Central Bank of Norway).

Dr Rodney Strachan, Research School of Economics, The Australian National University.

Visitors to CAMA @ ANU

Recent Visitors to CAMA include:

Dr Francesco Ravazzolo, Norges Bank (Central Bank of Norway) March 2010. Dr Ravazzolo presented a seminar on Wednesday 3rd March – *Was There a US Real Estate Bubble? Evidence from Multi-Factor Models for REIT Returns.*

Dr Pierre Siklos, Wilfrid Laurier University 21 - 27 March 2010 Dr Siklos presented a seminar on Friday 26th March – *A Failure to Communicate? Central Bank Interest Rate Guidance in Good Times and in Bad.*

Professor Mark Wright University of California, Los Angeles 28 June - 2 July 2010 Professor Wright presented a seminar on Friday the 2nd July- *Distinguishing Across Models of International Capital Flows.*

CAMA Staff at ANU are looking forward to welcoming the upcoming visits by:

Dr Gerald P Dwyer, Federal Reserve Bank of Atlanta 20 October - 29 October 2010

Professor Mardi Dungey, University of Tasmania 20 October - 29 October 2010

Dr Jan Jacobs, University of Groningen 20 October - 29 October 2010

Professor David Vines, University of Oxford 27 September - 23 December 2010

CAMA Newsletter **Issue 9, July 2010**

Professor Peter Smith University of York 04 August - 10 August 2010

Professor Karen Mumford, University of York 04 August - 10 August 2010

New Working Papers

Click on the title to download a paper.

18/2010

Four Centuries of British Economic Growth: The Roles of Technology and Population
By JB Madsen, JB Ang and R Banerjee

Using long historical data for Britain over the period 1620-2006, this paper seeks to explain the importance of innovative activity, population growth and other factors in inducing the transition from the Malthusian trap to the post-Malthusian growth regime. Furthermore, the paper tests the ability of two competing second-generation endogenous growth models to account for the British growth experience. The results suggest that innovative activity was an important force in shaping the Industrial Revolution and that the British growth experience is consistent with Schumpeterian growth theory.

17/2010

What determines European real exchange rates?
By M Berka and BD Michael

We study a newly constructed panel data set of relative prices of a large number of consumer goods among 31 European countries. We find that there is a substantial and non-diminishing deviation from PPP at all levels of aggregation, even among eurozone members. However, real exchange rates are very closely tied to relative GDP per capita within Europe, both across countries and over time. This relationship is highly robust at all levels of aggregation. We construct a simple two-sector endowment economy model of real exchange rate determination. Simulating the model using the historical relative GDP per capita for each country, we find that for most (but not all) countries there is a very close fit between the actual and simulated real exchange rate.

16/2010

Financial Contagion and the Real Economy
By DG Baur

The global financial crisis of 2008 was a crisis affecting both the financial sector and the "real economy". This paper analyzes the transmission of unexpected shocks from the financial sector in the US to other countries and sectors. We test the hypothesis that the financial crisis spread from the financial sector to the real economy by infecting financial stocks and real economy stocks across most financial markets. The empirical analysis comprising ten sectors in 25 major developed and emerging stock markets shows that the crisis led to an increased co-movement of unexpected shocks and thus contagion in financial stocks globally. In contrast, the evidence for contagion from the financial sector to other sectors is weak and most sectors exhibit a decreased transmission of shocks during the financial crisis. The findings suggest that investors differentiated across sectors and countries despite the severity of the financial crisis and the increased level of uncertainty.

15/2010

Reciprocal Brokered Deposits and Bank Risk
By S Shaffer

Economic theory predicts that reciprocal brokered deposits, by facilitating an extension of deposit insurance coverage, may exacerbate moral hazard and reduce market discipline for banks, permitting them to take more risk in various dimensions. Using a newly available dataset, this note explores empirical evidence related to that hypothesis.

14/2010

Fiscal Policy with Intertemporally Non-Separable Preferences
By L Bossi and PG Porqueras

In this paper, we show that Ricardian equivalence does not hold in a representative agent framework if one considers goods whose current consumption affect future marginal utilities. We find that, when the intertemporal elasticity of substitution changes over time, the timing of lump sum taxation has an asymmetric effect on current and future consumption. This in turn induces distinctive welfare consequences even if the government and individual budget constraints are unchanged in present value terms.

13/2010

Inventories, Inflation Dynamics and the New Keynesian Phillips Curve
By TA Lubik and WL Teo

We introduce inventories into an otherwise New Keynesian model and study the implications for inflation dynamics. Inventory holdings are motivated as a means to generate sales for demand-constrained firms. We derive various representations of the New Keynesian Phillips curve with inventories and show that one of these specifications is observationally equivalent to the standard model with respect to the behaviour of inflation when the model's cross-equation restrictions are imposed. However, the driving variable in the New Keynesian Phillips curve – real marginal cost – is unobservable and has to be proxies by, for instance, unit labour costs. An alternative approach is to impute

marginal costs by using the model's optimality conditions. We show that the stock-sales ratio is linked to marginal cost. We also estimate these various specifications if the New Keynesian Phillips curve using GMM. We find that predictive power of the inventory-specification at best approaches that of the standard model, but does not improve upon it. We conclude that inventories do not play a role in expanding inflation dynamics within out New Keynesian Phillips curve framework.

12/2010

The Ageing, Longevity and Crowding Out Effects on Private and Public Savings
By B Wong and KK Tang

Life-cycle theory predicts ageing exerting long-term macroeconomic impacts through the reduction of private savings. However, empirical research studying macroeconomic determinants of savings generally regard age dependency as the sole measure of ageing, but overlook longevity, which can also give rise to population ageing but exerts an opposite impact on private savings. This paper addresses this potential bias by considering the joint effects age dependency and longevity have on savings. In contrast to the wider literature, not only private savings, but also public savings was studied. Applying dynamic panel models to a dataset of 55 countries over 1972-2004, age dependency was found to exert a negative effect on private savings. However, some of these reductions can potentially be offset by increased longevity. The study also revealed some level of crowding out of private savings by changes in public savings and finds that the Ricardian Equivalence Hypothesis cannot be entirely dismissed.

11/2010

Innovation, Technological Change and the British Agricultural Revolution
By JB Ang, R Banerjee and JB Madsen

Theory, historiography and empirical evidence suggest that agriculture is the key to economic development. This paper examines the extent to which productivity advances in British agriculture in the period 1620-1850 were driven by technological progress. Measuring technology by patents and new book titles on agricultural methods, the results indicate that technological progress has played a significant part in productivity advances. Furthermore, the results show that research effort has permanent growth effects, consistent with the prediction of Schumpeterian growth theory.

10/2010

Forecast Densities for Economic Aggregates from Disaggregate Ensembles
By F Ravazzolo and S Vahey

We propose a methodology for producing forecast densities for economic aggregates based on disaggregate evidence. Our ensemble predictive methodology utilizes a linear mixture of experts framework to combine the forecast densities from potentially many component models. Each component represents the univariate dynamic process followed by a single disaggregate variable. The ensemble produced from these components approximates the many unknown relationships between the disaggregates and the aggregate by using time-varying weights on the component forecast densities. In our application, we use the disaggregate ensemble approach to forecast US Personal Consumption Expenditure inflation from 1997Q2 to 2008Q1. Our ensemble combining the evidence from 11 disaggregate series outperforms an aggregate autoregressive benchmark, and an aggregate time-varying parameter specification in density forecasting.

9/2010

Fiscal policy, composition of intergenerational transfers, and income distribution
By J Alonso-Carrera, J Caballé and X Raurich

In this paper, we characterize the relationship between the initial distribution of human capital and physical inheritances among individuals and the long-run distribution of these two variables. In a model with indivisible investment in education, we analyze how the initial distribution of income determines the posterior intergen-gerational mobility in human capital and the evolution of intragenerational income inequality. This analysis enables us in turn to characterize the effects of fiscal policy on future income distribution and mobility when the composition of inter-generational transfers is endogenous. We find that a tax on inheritance results in both less intergenerational mobility and smaller investment in human capital. However, a tax on labor income may promote human capital accumulation if the education premium is sufficiently high.

8/2010

Market Efficiency Test in the VIX Futures Market
By J Zhang, LW Sanning and S Shaffer

This paper tests the random walk hypothesis and weak form market efficiency in the VIX futures market using a variety of tests. A unit root in the aggregated market price series suggests that the VIX futures market is efficient. For the individual VIX futures price series, 51 of 54 futures contracts meet the sufficient condition for an efficient market: the prices are found to follow a random walk either because there is a unit root or because the increments are not correlated. Overall, the market for VIX futures has been efficient since the first day of trading.

CAMA Newsletter   **Issue 9, July 2010**

7/2010
Inventories and Optimal Monetary Policy
By TA Lubik and WL Teo

We introduce inventories into a standard New Keynesian Dynamic Stochastic General Equilibrium (DSGE) model to study the effect on the design of optimal monetary policy. The possibility of inventory investment changes the transmission mechanism in the model by decoupling production from final consumption. This allows for a higher degree of consumption smoothing since firms can add excess production to their inventory holdings. We consider both Ramsey optimal monetary policy and a monetary policy that maximizes consumer welfare over a set of simple interest rate feedback rules. We find that in contrast to a model without inventories, Ramsey-optimal monetary policy in a model with inventories deviates from complete inflation stabilization. In the standard model, nominal price rigidity is a deadweight loss on the economy, which an optimizing policymaker attempts to remove. With inventories, a planner can reduce consumption volatility and raise welfare by accumulating inventories and letting prices change as an equilibrating mechanism. We find also find that the application of simple rules comes very close to replicating Ramsey optimal outcomes.

6/2010
Bank Window Dressing: A Re-Assessment and a Puzzle
By S Yang and S Shaffer

Expanded public availability of U.S. banking data has prompted a need to re-examine end-of-quarter window dressing. We find substantial heterogeneity in the pattern of window dressing across banks and products, not all of which can be explained as customerinitiated,
and some of which is consistent with theoretical predictions in the absence of publicly available data. These findings call into question the efficacy of financial disclosure in constraining banks' behavior, and raise new issues for further research.

5/2010
Can Second-Generation Endogenous Growth Models Explain The Productivity Trends and Knowledge Production In The Asian Miracle Economies?
By JB Ang and JB Madsen

Using data for six Asian miracle economies over the period from 1953 to 2006, this paper examines the extent to which growth has been driven by R&D and tests which second-generation endogenous growth model is most consistent with the data. The results give strong support to Schumpeterian growth theory but only limited support to semi-endogenous growth theory. Furthermore, it is shown that R&D has played a key role for growth in the Asian miracle economies.

4/2010
Between Estimates of the Environmental Kuznets Curve
By Stern DI

Recent papers by Wagner in this journal and Vollebergh et al. in the Journal of Environmental Economics and Management point out some fundamental econometric problems with traditional methods of estimating the environmental Kuznets curve (EKC) and propose alternative approaches that avoid these issues. Wagner notes that traditional methods do not take into account the presence of powers of unit root variables and cross-sectional dependence in the data while Vollebergh et al point out that the time effects are not uniquely identified in the EKC model. The between estimator is a simple estimator that also addresses the concerns of these authors. It makes no a priori assumption about the nature of the time effects and is likely to provide consistent estimates of long-run relationships in real world data situations. I apply several common panel data estimators including the between estimator to the datasets for carbon and sulfur emissions in the OECD and global sulphur emissions. The between estimates of the sulfur-income elasticity are 0.732 in the OECD and 1.067 in the global data set and the estimated carbon-income elasticity is 1.612 in the OECD and 1.509 globally.

3/2010
General-Equilibrium Effects of Investment Tax Incentives
By RM Edge and JB Rudd

This paper develops a new-Keynesian model with nominal depreciation allowances to consider the effects of temporary tax-based investment incentives on capital spending and real activity. In particular, we investigate the effects of a temporary expensing allowance on investment in partial and general equilibrium and challenge the conventional view, advanced by Auerbach and Summers (1979) and Judd (1985), that partial-equilibrium analyses overstate the calculated impact of such policies. We also explore two additional questions. First, we investigate a claim noted by Auerbach and Summers and analysed by Christiano (1984) that such incentives can be destabilizing. Second, we consider the relative impact of two types of tax-based investment incentives: a temporary partial-expensing allowance and a temporary reduction in capital taxes.

2/2010
Expectations Traps and Coordination Failures: Selecting Among Multiple Discretionary Equilibria
By R Dennis and T Kirsanova

Discretionary policymakers cannot manage private-sector expectations and cannot co-ordinate the actions

of future policymakers. As a consequence, expectations traps and coordination failures can occur and multiple equilibria can arise. In order to utilize the explanatory power of models with multiple equilibria it is necessary to understand how an economy arrives to a particular equilibrium. In this paper, we employ notions of robustness, learnability, and the potential for policy errors to motivate and develop a suite of equilibrium selection criteria. Central among these criteria are whether the equilibrium is learnable by private agents and jointly learnable by private agents and the policymaker. We use two New Keynesian policy models to identify the strategic interactions that give rise to multiple equilibria and to illustrate our equilibrium selection methods. Importantly, although the Pareto-preferred equilibrium is invariably an equilibrium identified by standard numerical iterative solution methods, unless it is learnable by private agents, we find little reason to expect coordination on that equilibrium.

1/2010

Threshold Pricing in a Noisy World
By T Henckel, GD Menzies and DJ Zizzo

We propose that the formation of beliefs be treated as statistical hypothesis tests, and label such beliefs inferential expectations. If a belief is overturned due to sufficient contrarian evidence, we assume agents switch to the rational expectation. We build a state dependent Phillips curve, and show that adjustments to equilibria may be contaminated by signal censoring, where agents in possession of extreme information are the first to adjust to changed economic circumstances. This approach is able to replicate recent micro-level evidence on firms' pricing behavior and sheds light onto the dynamics of disaggregated prices.

27/2009

Assessing Competition with the Panzar-Rosse Model: The Role of Scale, Costs, and Equilibrium
By JA Bikker, S Shaffer and L Spierdijk

The Panzar-Rosse model has been widely applied to assess competitive conduct, often in specifications controlling for firm scale or using a price equation. We show that neither a price equation nor a scaled revenue function yields a valid measure for competitive conduct. Moreover, even an unscaled revenue function generally requires additional information about costs and market equilibrium. Our theoretical findings are confirmed by an empirical analysis of competition in banking, using a sample covering more than 110,000 bank-year observations on almost 18,000 banks in 67 countries during 1986-2004.

26/2009

Catching up to the Technology Frontier: The Dichotomy Between Innovation and Imitation

By JB Madsen, Md. R Islam and J Ang

This research examines whether technology transfer, research intensity, educational attainment and the ability to absorb foreign technology help explain cross-country differences in productivity growth. Our data comprise a panel of 55 countries including 23 OECD and 32 developing economies over the period 1970-2004. The results show that TFP growth in both OECD and developing countries is positively affected by research intensity, distance to the frontier, research intensity-based absorptive capacity and educational attainment-based absorptive capacity. However, they reveal large differences between developed and developing countries.

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