

Welcome: In Summary


Welcome to the eleventh edition of the CAMA Newsletter. CAMA continues to strengthen with more research associates joining the program, bringing the number of research associates close to 180. CAMA members are now represented across 85 institutions, of which 78% are outside Australia, with 35% coming from the non-university sector.

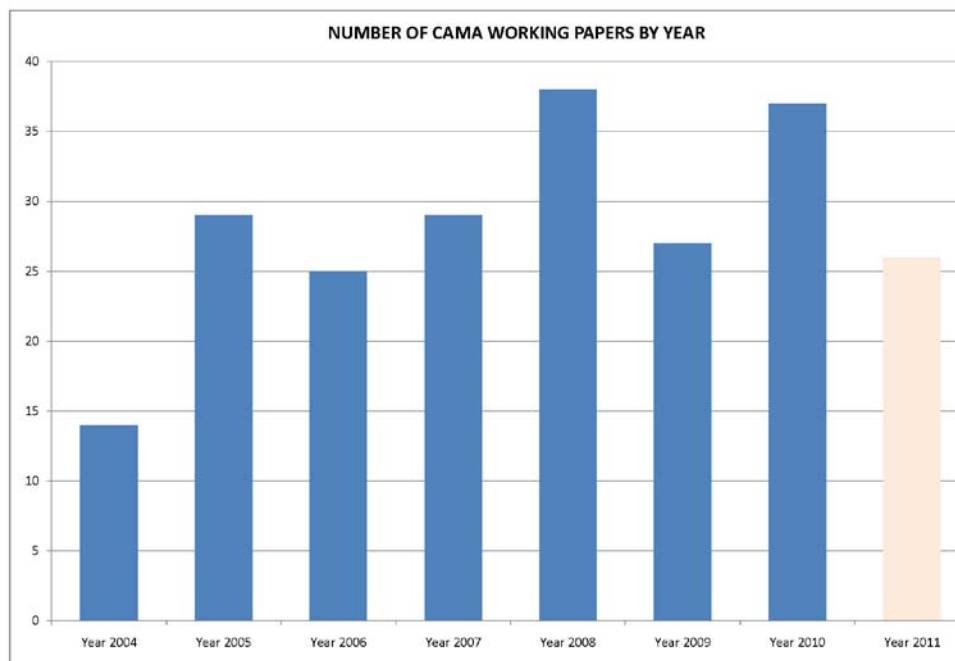
We are delighted with the number of working papers that have been published in CAMA's working paper series, with 28 new papers since our last newsletter. Figure 1 shows the number of working papers by year. A full list with abstracts are included in this newsletter, all working papers are freely available for download from CAMA's website, <http://cama.anu.edu.au/publications.asp>.

CAMA has been busy with participation in a number of exciting conferences. July proved to be a particularly busy time which included the following events:

- **An Introduction to Bayesian Econometrics & Time Series Modeling, course held at RSE, ANU**
- **6th Workshop on Macroeconomic Dynamics (WMD 2011)**

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Figure 1

Staff News

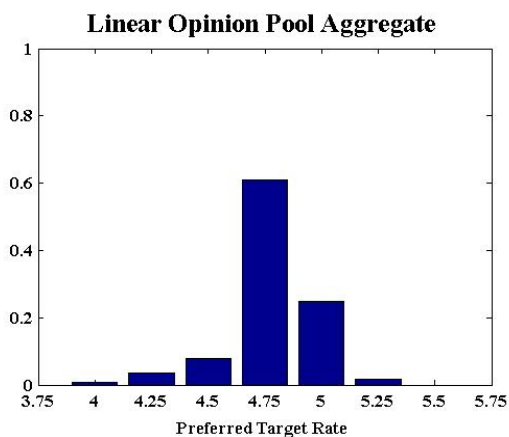
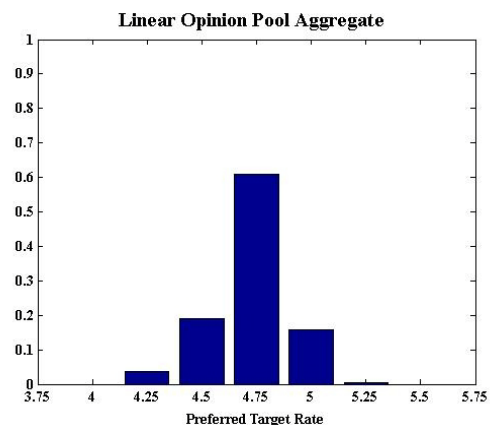
We are delighted to welcome **Mr. Damien Hughes** as our Centres Executive Administrator. Damien comes with experience in Centre operations having previously worked in the ARC Centre of Excellence for Quantum-Atom Optics as Chief Operations Officer. He has been on staff at ANU since 2003. He joined CAMA in May 2011.

We would also like to welcome **Mrs. Rossana Bastos-Pinto** as the Centres Administrator. She worked previously with SPEAR and she joined CAMA in May of 2011. Those members who have recently submitted working papers will be familiar with Rossana.

Other News

Website. While you may not have noticed, the CAMA website has recently been updated with a hidden tool that measures the number of site visits. Using Google Analytics the early results are promising with over 305 site visits coming from 24 countries since 1 August. With some further initiatives in the pipeline we hope to increase traffic well above this.

'PRO-POL Probabilistic interest rate setting project'. In collaboration with a number of senior Australian Economists, CAMA has launched a shadow RBA board that will look at interest rate setting by monetary policymakers. The members of a Shadow Board give probabilistic assessments of the appropriate (target) interest rate for Australia in real time. Already this project has been given some media attention with a number of news websites, including the Australian Financial Review. For more information, please visit: <http://cama.anu.edu.au/ShadowRBAboard.asp>, or [working paper 27/2011](#).

August 2011 outcome

September 2011 outcome


Congratulations to **Dr Russell Toth** who recently joined the School of Economics at the University of Sydney as a Lecturer on July 1, 2011. Russell is an active member in the 'Economic Growth and Development' program.

We would like to extend our congratulations to **Professor Bruce Chapman**, who has recently been nominated by Professor Masahiko Aoki of Stanford University to serve on the Executive Committee of the International Economics Association. The President-elect of the Executive Committee is Professor Joseph Stiglitz.

Jan Libich from La Trobe University has recently started presenting video interviews with a number of academics and policymakers. Some topics of the interviews are: monetary-fiscal interactions; current state of the European Union and possible future scenarios; the past and future of central banking, monetary policy, and fiscal sustainability; and the pros and cons of a currency union, Europe's debt problems and the future of the Euro.

The interviews can be accessed at: www.youtube.com/user/JanLibich1

Future Events

First Annual VUW Macro Workshop – 21 October 2011

School of Economics and Finance at Victoria University of Wellington, in conjunction with CAMA, are organizing the First Annual VUW Macro Workshop. The workshop aims to establish a regular venue for advancing research in macroeconomics in New Zealand, Australia, and the wider region. Submissions should be made by 15 September 2011.

For more information, please visit <https://sites.google.com/site/vuwmacroworkshop2011/home>

NZ RBA conference on “Macro policies after the crisis” – 12-13 December 2011

The conference aims to draw together theoretical and empirical work on the factors motivating new policies, the effective use of existing and potential policy instruments, and interaction among policies. The conference is organized by the Reserve Bank of New Zealand in conjunction with CAMA, 12-13 December 2011. Submissions should be made by 9 September 2011.

For more information, please visit <http://www.rbnz.govt.nz/research/workshops/MacroDec2011/conference.html>

RBA Workshop on “Quantitative Macroeconomics” – 15-16 December 2011

The Reserve Bank of Australia is holding its annual Research Workshop on ‘Quantitative Macroeconomics’ in Sydney on 15–16 December 2011. The workshop is intended to bring together academics and practitioners to discuss recent developments in macroeconomics. Contributions in all areas of macroeconomics, particularly those relevant to an open economy such as Australia are welcome. Submission by 18 September 2011.

For more information, please visit <http://www.rba.gov.au/publications/workshops/>

AIB MENA conference on “Managing in Uncertain Times” - 13-15 January 2012

The Zayed University Dubai will host the Academy of International Business, Middle East & North Africa conference (AIB MENA). The 2nd Annual Chapter conference will be held in Zu Dubai (Academic City) campus from 13th to 15th January, 2012. Papers from any field within economics and finance are welcome. Please submit your paper (s) to kerim.arin@zu.ac.ae before 10th September, 2011.

For more information, please visit <http://www.uowdubai.ac.ae/aib/details.php?sec=5,2>

Report on recent events

An Introduction to Bayesian Econometrics & Time Series Modelling - CAMA (ANU)

This nine-day course provided an introduction to contemporary Bayesian econometric modelling, with an emphasis on time series modelling. Professor Mike Smith from Melbourne Business School was the main presenter along with Shaun Vahey and Rodney Strachan. The workshop was well attended by CAMA members and others, including a number of local, national and international participants.

Bank of England and CAMA (ANU) Workshop: 15 April 2011 in London

This was a workshop about Densities, Forecasting and Communicating Uncertainty. Attendee's included Shaun Vahey, Simon Price, Renee Fry, Kalvinder Shields, Simon Van Norden and Warwick McKibbin.

Royal Economic Society Annual Conference 2011 Special Session "Probability Forecasts and Monetary Policy"

CAMA presented a special session at the Royal Economic Society Annual Conference 2011 in London on April 18th, 2011 which focused in communicating probabilities and forecast densities for monetary policy.

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More details about the CAMA special session can be found at http://cama.anu.edu.au/RES_2011.asp and details about the Royal Economic Society Annual Conference can be found at <http://www.resconference.org.uk/>.

The 16th Australasian Macroeconomic Workshop 2011

The Workshop was hosted by the University of Tasmania, from Thursday 28 April, to Friday 29 April, 2011. For details visit http://www.utas.edu.au/ecofin/home/AMW2011/macroworkshop_2011.html

The Econometric Society Australasian Meeting in 2011 (ESAM11)

The Econometric Society Australasian Meeting in 2011 (ESAM11) was held in Adelaide, Australia, 4 - 7 July and hosted by the University of Adelaide. The program consisted of invited speakers and contributed papers on a wide range of both theoretical and applied areas of microeconomic theory, international trade and econometric theory.

More details can be found at <http://www.alloccasionsgroup.com/ESAM2011>

ACE2011 – 40th Australian Conference of Economists

On 11 – 13 July, the Australian Conference of Economists hosted seven plenary speakers, several panels, and a variety of special sessions. The conference received around of two hundred refereed contributed papers.

More details can be found at <http://www.ace2011.org.au/>

6th Workshop on Macroeconomic Dynamics (WMD 2011)

The 6th Workshop on Macroeconomic Dynamics (WMD 2011) was organized by the School of Economics, University of Queensland in conjunction with CAMA, 24 - 25 July 2011.

Publication News



If you have a publication that you would like to report in this section of future editions of the newsletter, please email the details to Rossana Bastos Pinto at cama.admin@anu.edu.au.

Dr Emmanuel De Veirman of the Finance and the Macroeconomy Program:

- With A Dunstan, “Time-Varying Returns, Intertemporal Substitution and Cyclical Variation in Consumption” BE Journal of Macroeconomics (Topics). [**CAMA Working Paper 14/2011**]

Dr Jan Libich of the Macroeconomic Policy Frameworks Program:

- With J Savage and CE Walsh, “Monetary-Fiscal Interactions: How To Improve Policy Outcomes?” Symposium at ACE 2010, Economic Papers, 30(1), pp1-5
- “Inflation Nutters? Modelling the Flexibility of Inflation Targeting” The B.E. Journal of Macroeconomics (Topics), 11(1), Article 17 [**revised CAMA Working Paper 2/2006**].
- With P Stehlik, “Endogenous Monetary Commitment” Economics Letters, 112, pp103–106 [**CAMA Working Paper 1/2009**]

Dr Melisso Boschi of the Finance and the Macroeconomy Program:

- With A Girardi, “The contribution of domestic, regional and international factors to Latin America’s business cycle” Economic Modelling, Elsevier, vol. 28(3), pages 1235-1246, May. [**CAMA Working Paper 33/2008**]

Dr Dirk Baur of the Finance and the Macroeconomy Program:

- “The Asymmetric Volatility of Gold”. Forthcoming in Journal of Alternative Investments.

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- “Financial Contagion and the Real Economy” Forthcoming in Journal of Banking & Finance [**CAMA Working Paper 16/2010**]

- “Explanatory mining for Gold: An Empirical Investigation of the Relationship of Gold and US Economic and Financial Data”. Forthcoming in Resources Policy

- With C McKeating “Do Football Clubs benefit from an IPO?” International Journal of Sports Finance, February 2011

Dr Arusha Cooray of the Finance and the Macroeconomy Program:

- With N Potrafke, “Gender Inequality in Education: Political Institutions or Culture and Religion?”. European Journal of Political Economy, 27 (2), 268-280.

- “The Role of the Government in Financial Sector Development”. Economic Modelling, 28(3), 928-938.

Dr Timo Henckel of the Behavioural Macroeconomics Program:

- With G Menzies, N Prokhovnik, and D Zizzo. “Barro-Gordon revisited: Reputational equilibria with inferential expectations”. Economic Letters, vol 112, no 2011, pp. 144-147. [**CAMA Working Paper 29/2010**].

Dr Nicolas Groshenny of the Macroeconomic Theory Program:

- “Monetary Policy, Inflation and Unemployment In Defence of Fed”. Forthcoming in Macroeconomic Dynamics. [**CAMA Working Paper 37/2010**].

New Research Associates



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

Program Affiliation TBA

Associate Professor Alfred Guender, Department of Economics, University of Canterbury

Dr Anthony Garratt, Department of Economics, Mathematics & Statistics, Birkbeck, University of London, London

Professor James Mitchell, NIESR and Leicester University, United Kingdom.

Professor Lex Oxley, Department of Economics, University of Canterbury, New Zealand

Associate Professor Patrick Coe, Department of Economics, Carleton University, Canada

Dr Roland Meeks, Reserve Bank of New Zealand. Bank of England, London

Economic Growth and Development

Mr Russell Toth, Department of Economics, Cornell University, USA

Macro-econometric Models and Methods

Dr Prasad Bhattacharya, Deakin University, Victoria.

Macroeconomic Theory

Dr Cagri Kumru, Research School of Economics, The Australian National University, Canberra.

Model Uncertainty and Macro-Econometrics

Dr Todd Clark, Economic Research Department, Federal Reserve Bank of Cleveland, USA

Mr Christopher Smith, Reserve Bank of New Zealand, New Zealand

Finance and the Macroeconomy

Dr Chiara Oldani, University of Viterbo “La Tuscia”, Italy

Multi-Country Models and Methods

Dr Ippei Fujiwara, Bank of Japan, Japan

CAMA welcomes new research associates. Applications can be sent to program directors with a CV and statement of interest in their chosen program.

New Doctoral Associates

Climate Change and Energy

Mr Akshay Shanker

Ms Hyenjin Park

Mr Wei Jin

Ms Yingying Lu

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Mr Weifeng (Larry) Liu

Multi-Country Models and Methods

Ms Thitima Chucherd

Visitors to CAMA @ ANU



Recent Visitors to CAMA include:

Ms Yong Jortzik-Yan, The Treasury, 21 March – 24 June 2011

Associate Professor Facundo Sepulveda, Universidad de Santiago de Chile, 6 May – 21 May 2011

Assistant Professor Martin Davis, Washington and Lee University, 19 May-29 July 2011

Dr Chrismin Tang, La Trobe University, 20 June-1 July 2011

Professor Michael Smith, University of Melbourne, 11 July to 18 July 2011

Dr Gordon Menzies, University of Technology, Sydney, 11 July to 18 July 2011

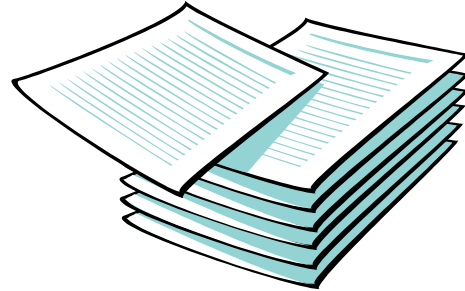
CAMA Staff at ANU are looking forward to welcoming upcoming visits by:

Dr Clifford Winston, The Brookings Institute, 4 September - 9 September 2011.

Professor Thomas Lubik, Federal Reserve Bank of Richmond, December.

New Working Papers

Click on the title to download a paper.



2011

5/2011

[Improving forecasting performance by window and model averaging](#)

By Bhattacharya PS and Thomakos DD

This study presents extensive results on the benefits of rolling window and model averaging. Building on the recent work on rolling window averaging by Pesaran et al (2010, 2009) and on exchange rate forecasting by Molodtsova and Papell (2009), we explore whether rolling window averaging can be considered beneficial on a priori grounds. We investigate whether rolling window averaging can improve the performance of model averaging, especially when 'simpler' models are used. The analysis provides strong support for rolling window averaging, outperforming the best window forecasts more than 50% of the time across all rolling windows. Furthermore, rolling window averaging smoothes out the forecast path, improves robustness, and minimizes the pitfalls associated with potential structural breaks.

6/2011

[Trust in Public Institutions over the Business Cycle](#)

By Stevenson B and Wolfers J

We document that trust in public institutions—and particularly trust in banks, business and government—has declined over recent years. U.S. time series evidence suggests that this partly reflects the pro-cyclical nature of trust in institutions. Cross-country comparisons reveal a clear legacy of the Great Recession, and those countries whose unemployment grew the most suffered the biggest loss in confidence in institutions, particularly in trust in government and the financial sector. Finally, analysis of several repeated cross-sections of confidence within U.S. states yields similar qualitative patterns, but much smaller magnitudes in response to state-specific shocks.

7/2011

[How Prediction Markets can Save Event Studies](#)

By Snowberg E, Wolfers J and Zitzewitz E

This review paper articulates the relationship between prediction market data and event studies, with a special focus on applications in political economy. Event studies have been used to address a variety of political economy questions—from

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the economic effects of party control of government to the importance of complex rules in congressional committees. However, the results of event studies are notoriously sensitive to both choices made by researchers and external events. Specifically, event studies will generally produce different results depending on three interrelated things: which event window is chosen, the prior probability assigned to an event at the beginning of the event window, and the presence or absence of other events during the event window. In this paper we show how each of these may bias the results of event studies, and how prediction markets can mitigate these biases..

8/2011[Inflation variability and the relationship between inflation and growth](#)

By Jha R and Dang T

We examine the effect of inflation variability and economic growth using annual historical data on both developing and developed countries. The data cover 182 developing countries and 31 developed countries for the period 1961-2009. Proxying inflation variability by the five-year coefficient of variation of inflation, we obtain the following results: (1) For developing countries, there is significant evidence to suggest that when the rate of inflation exceeds 10 % inflation variability has a negative effect on economic growth. (2) For developed countries, there is no significant evidence that inflation variability is detrimental to growth.

9/2011[Global Fiscal Consolidation](#)

By McKibbin WJ and Stoeckel AB

The build up in government debt in response to the 'great recession' has raised a number of policy dilemmas for individual countries as well as the world as a whole. Where the government fiscal stimulus was seen as necessary to restore confidence to markets and stimulate deteriorating economies in the aftermath of the 'great recession' by 2010 the massive fiscal stimulus programs and associated run-up in debt had, for many economies, become a confidence sapping exercise. This need for a change of fiscal policy stance has fuelled another debate that has two related aspects. One is the impact of fiscal consolidation on economies that are tightening and the flow-on effects to the world economy. The other debate is how much tightening there should be and how quickly.

This paper explores these issues in a global framework focussing on the national and global consequences of coordinated fiscal consolidation. It explores the implications this fiscal adjustment might have on country risk premia and what happens if all countries coordinate their fiscal adjustment except the United States. A coordinated fiscal consolidation in the industrial world that is not accompanied by US actions is likely to lead to a substantial worsening of trade imbalances globally as the release of capital in fiscally contracting economies flows into the US economy, appreciates the US dollar and worsens the current position of the US. The scale of this change is likely to be sufficient to substantially increase the probability of a trade war between the United States and other economies. In order to avoid this outcome, a coordinated fiscal adjustment is clearly in the interest of the global economy.

10/2011[Contrasting Giants: Demographic Change and Economic Performance in China and India](#)

By Golley J and Tyers R

The timing of China's and India's demographic transitions and the implications of alternative fertility scenarios are here explored using a global economic model incorporating full demographic behavior and measures of dependency that include the working aged and those of working age who do not work. The results show that, while the path of total dependency in China will be comparatively flat, the positive contribution of declining youth dependency to real per capita income will not be offset by rising aged dependency until beyond 2030. India's dependency ratio declines more sharply. Its higher initial fertility contributes positively to growth in GDP while weakening that in its real per capita income. Yet, so long as fertility continues to decline the latter negative effect will be partially offset by a demographic dividend worth at least five per cent of its 2000 real per capita income over more than three decades.

11/2011[An Application of Models of Speculative Behaviour to Oil Prices](#)

By Shi, SP and Arora V

We estimate three different models of speculative behaviour using oil price data. There are two major results: (i) The three regime model of Brooks and Katsaris (2005) and a three regime variant of van Norden and Schaller (2002) fit the oil price data reasonably well; and (ii) Both models show that the probabilities of being in a bubble collapsing state and a bubble expansion state spike in late-2008/early-2009. This provides some support for the claim by Phillips and Yu (2010) and Gilbert (2010) that a bubble in oil prices existed for short period in 2008.

12/2011[Actually This Time Is Different](#)

By Fry R, Hsiao CYL and Tang C

Episodes of extraordinary turbulence in global financial markets are examined during eight crises ranging from Asia in 1997-98 to the recent great recession of 2008-10. The analysis focuses on changes in the dependence structures of equity markets through correlation and coskewness to answer the question of whether the great recession is different to other crises in terms of shock transmission through contagion. The results show that 'this time is different' and that the great recession is truly a global financial crisis. Other US sourced crises do not affect other markets through contagion, and emerging market crises transmit unexpectedly.

13/2011[The cyclicity of skill acquisition: evidence from panel data](#)

By Sepulveda F and Mendez F

This paper presents new empirical evidence regarding the cyclicity of skill acquisition activities. The paper studies both

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training and schooling episodes at the individual level using quarterly data from the NLSY79 for a period of 19 years. We find that aggregate schooling is strongly countercyclical, while aggregate training is acyclical. Several training categories however behave procyclically. The results also indicate that firm-financed training is procyclical while training financed through other means is countercyclical; and that the cyclicity of skill acquisition investments depends significantly on the educational level and the employment status of the individual.

14/2011

[Time-Varying Returns, Intertemporal Substitution and Cyclical Variation in Consumption](#)

By Veirman ED and Dustan A

This paper studies the importance of intertemporal substitution in consumption for the cyclical co-movement of consumption, net worth and income. We can largely explain the empirical hump-shaped consumption response to a transitory wealth increase by allowing for time-varying returns in an otherwise standard Permanent Income Hypothesis (PIH) model. At the net worth peak, households bring consumption forward in anticipation of low returns on saving. The PIH model fully explains the empirical response when households initially expect the net worth shock to be permanent, but gradually learn that it is in fact transitory.

15/2011

[Information, data dimension and factor structure](#)

By Jacobs JPAM, Otter PW and Reijer AHJ

This paper employs concepts from information theory to choosing the dimension of a data set. We propose a relative information measure connected to Kullback-Leibler numbers. By ordering the series of the data set according to the measure, we are able to obtain a subset of a data set that is most informative. The method can be used as a first step in the construction of a dynamic factor model or a leading index, as illustrated with a Monte Carlo study and with the U.S. macroeconomic data set of Stock and Watson [22].

16/2011

[Measuring Output Gap Nowcast Uncertainty](#)

By Garratt A, Mitchell J and Vahey SP

We propose a methodology to gauge the uncertainty in output gap nowcasts across a large number of commonly-deployed vector autoregressions in US inflation and various measures of the output gap. Our approach constructs ensemble nowcast densities using a linear opinion pool. This yields well-calibrated nowcasts for US inflation in real time from 1991q2 to 2010q1, in contrast to those from a univariate autoregressive benchmark. The ensemble nowcast densities for the output gap are considerably more complex than for a single VAR specification. They cannot be described adequately by the first two moments of the forecast densities. To illustrate the usefulness of our approach, we calculate the probability of a negative output gap at around 45 percent between 2004 and 2007. Despite the Greenspan policy regime, and some large point estimates of the output gap, there remained a substantial risk that output was below potential in real time. Our ensemble approach also facilitates probabilistic assessments of "alternative scenarios". A "dove" scenario (based on distinct

output gap measurements) typically raises substantially the probability of a negative output gap (including 2004 through 2007) but has little impact in slumps, in our illustrative example.

17/2011

[Oil Price Dynamics in a Real Business Cycle Model](#)

By Arora V and Gomis-Porqueras P

We show the importance of endogenous oil prices and production in the real business cycle framework. Endogenising these variables improves the model's predictions of business cycle statistics, oil related and non-oil related, relative to a situation where either is exogenous. This result is robust to the standard extensions (variable capacity utilisation and monopolistic competition) used in the literature. In particular, we first show that with either exogenous oil prices or production the standard real business cycle model and variants cannot match the oil-related and business cycle facts. In contrast, when both of these variables are endogenous, we can substantially improve the corresponding co-movements and slightly improve standard business cycle properties for consumption and investment.

18/2011

[Japan's Economic Recovery: Insights from Multi-Region Dynamics](#)

By Tyers R and Zhang Y

Despite its key contribution to global economic growth through the 1960s and 1970s, in recent decades the rise of China has seen the importance of Japan recede from the public discourse. This is notwithstanding its continuing key role as global investor and trading partner. Yet this role has been threatened by a tendency for its economy to stagnate since the 1990s and by the tragic earthquake of 2011, both of which have implications for global economic performance. This paper briefly reviews the many claimed sources of Japan's stagnation and then analyses the sources of recovery along with the implications of the 3-11 disaster, using a multi-region global dynamic model. Both demand and supply side determinants prove important though it is shown that a key future role will be played by the performance of Japan's services sector and of the industrial policies that affect it.

19/2011

[Price setting in a leading Swiss online supermarket](#)

By Berka M, Devereux MB and Rudolph T

We study a newly released data set of scanner prices for food products in a large Swiss online supermarket. We find that average prices change about every two months, but when we exclude temporary sales, prices are extremely sticky, changing on average once every three years. Non-sale price behavior is broadly consistent with menu cost models of sticky prices. When we focus specifically on the behavior of sale prices, however, we find that the characteristics of price adjustment seems to be substantially at odds with standard theory.

CAMA Newsletter**Issue 11, September 2011****20/2011**[Global Implications of Japanese Economic Stagnation](#)

By Tyers R

Despite its key contribution to global economic growth through the 1960s and 1970s, in recent decades the rise of China has seen the importance of Japan recede from the public discourse. This is notwithstanding its continuing key role as investor and trading partner. Yet this role has been threatened by a tendency for its economy to stagnate since the 1990s. This paper reviews the many claimed sources of Japan's stagnation and quantifies their independent effects using a multi-region global dynamic model. Supply side determinants emerge as strongest but their origins in the boom and bust cycle that followed the Plaza Accord of 1985 are not discounted. The stagnation is shown to have resulted in a loss in global and regional economic activity that has been severe for the Japanese yet, while robustly negative, has been relatively mild in other regions, disguised by the rise of China. Parallels are drawn with the more recent debate over China's exchange rate and the associated pressure for China to "look inward" for its growth.

21/2011[Asset Arbitrage and the Price of Oil](#)

By Arora V and Tyers R

It is commonly understood that macroeconomic shocks influence commodity prices and that one channel for this is the link between interest rates, expected future asset returns and stockholding. In this paper the link is extended to the petroleum market with the recognition that recorded stocks of oil comprise a small share of annual demand and that the parallel with storable commodities is the decision to produce the oil in the first place, as opposed to holding it in the ground as reserve. Oil reserves are then a key asset in producing countries, which is arbitrated against financial assets. Thus, when the yield on financial assets falls, retaining oil reserves becomes more attractive to producing countries, which then have less incentive to accommodate demand rises, and so the oil price rises. This perspective on oil pricing is modelled in a dynamic multi-region general equilibrium framework in which regional households manage portfolios of assets that include oil reserves. When the model is calibrated to match observed data over two decades, simulation results indicate that asset arbitrage made a large contribution to the high pre-GFC oil price.

22/2011[Financial intermediation and the international business cycle: The case of small countries with big banks](#)

By Thoenissen C and Kamber G

We examine the transmission mechanism of banking sector shocks in a two-country DSGE model. Assuming that the home country is small relative to the rest of world, we find that spillovers from foreign banking sector shocks are modest unless banks in the small country hold foreign banking assets. The correlation between home and foreign GDP rises with the exposure of the domestic banking sector to foreign bank assets.

23/2011[Forecasting in the presence of recent structural change](#)

By Eklund J, Kapetanios G and Price S

We examine how to forecast after a recent break. We consider monitoring for change and then combining forecasts from models that do and do not use data before the change; and robust methods, namely rolling regressions, forecast averaging over different windows and exponentially weighted moving average (EWMA) forecasting. We derive analytical results for the performance of the robust methods relative to a full-sample recursive benchmark. For a location model subject to stochastic breaks the relative MSFE ranking is EWMA < rolling regression < forecast averaging. No clear ranking emerges under deterministic breaks. In Monte Carlo experiments forecast averaging improves performance in many cases with little penalty where there are small or infrequent changes. Similar results emerge when we examine a large number of UK and US macroeconomic series.

24/2011[Auction Prices, Market Share, and a Common Agent](#)

By Coatney KT, Shaffer SL and Menkhaus DJ

The primary pro-competitive justification for multiple principals to hire a common bidding agent is efficiency. The efficiency gained by doing so increases the advantage of the common bidding agent. Almost common value auction theory predicts that an advantaged bidder is able to reduce competition by credibly enhancing the 'winner's curse' of disadvantaged rivals. The credible threat results in disadvantaged rivals exiting the bidding process early, leaving the advantaged bidder to purchase most, if not all, units at lower prices than when rivals have common values. The results of our empirical study of a common bidding agent are consistent with this theory.

25/2011[Bayesian Inference in a Time Varying Cointegration Model](#)

By Koop G, Leon Gonzalez R and Strachan RW

There are both theoretical and empirical reasons for believing that the parameters of macroeconomic models may vary over time. However, work with time-varying parameter models has largely involved Vector autoregressions (VARs), ignoring cointegrations. This is despite the fact that cointegration plays an important role in informing macroeconomists on a range of issues. In this paper we develop a new time varying parameter model which permits cointegration. We use a specification which allows for the cointegrating space to evolve over time in a manner comparable to the random walk variation used with TVP-VARs. The properties of our approach are investigated before developing a method of posterior simulation. We use our methods in an empirical investigation involving the Fisher effect.

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26/2011[A SVECM Model of the UK Economy and The Term Premium](#)

By Dungey M and Vehbi MT

The term premium is estimated from an empirically coherent open economy VAR model of the UK economy where the model specifically accounts for the mixed nature of the data and cointegration between some variables. Using this framework the estimated negative term premia for 1980-2007 is decomposed into its contributing shocks, where the role of inflation and monetary policy shocks are shown to be dominant in the evolution of the term premium. Projecting into the 2008 crisis period reveals the extent of the shocks to the UK economy, and also shows the similarities in term premia behaviour with those experienced during the 1998 Russian crisis.

27/2011[Probabilistic Interest Rate Setting with a Shadow Board: A Description of the Pilot Project](#)

By Henckel T, Vahey S and Wakerly L

This study aims to assess the scope for monetary policymakers to aggregate probabilistic interest rate advice. The members of a Shadow Board give probabilistic assessments of the appropriate (target) interest rate for Australia in real time. The pilot project will be running in August, September and October 2011, with the Shadow Board giving advice shortly before each decision by the Reserve Bank of Australia (RBA) Board.

28/2011[Time Varying Dimension Models](#)

By Chan JCC, Koop G, Leon-Gonzales R and Strachan RW

Time varying parameter (TVP) models have enjoyed an increasing popularity in empirical macroeconomics. However, TVP models are parameter-rich and risk over-fitting unless the dimension of the model is small. Motivated by this worry, this paper proposes several Time Varying Dimension (TVD) models where the dimension of the model can change over time, allowing for the model to automatically choose a more parsimonious TVP representation, or to switch between different parsimonious representations. Our TVD models all fall in the category of dynamic mixture models. We discuss the properties of these models and present methods for Bayesian inference. An application involving US inflation forecasting illustrates and compares the different TVD models. We find our TVD approaches exhibit better forecasting performance than many standard benchmarks and shrink towards parsimonious specifications.

Full CAMA Working Paper Series

The entire CAMA working paper series is available on the website at <http://cama.anu.edu.au/publications.asp> or through Repec at <http://econpapers.repec.org/paper/acbcamaaa/>

Paper Submission

If you would like to submit a paper for inclusion in the working paper series, please email to your program director for consideration

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