Discussion of
“Supply Shocks and Monetary Policy Responses in Emerging Economies”
by José Antonio Ocampo and Jair Ojeda-Joya

Youel Rojas

Central Bank of Peru

XXVI Meeting of the Central Bank Researchers Network.
This paper

**Very important Question**
- How is the Monetary Policy (MP) reaction function after a supply shocks in EM?
- Which factors influence the MP response?

**Motivation**
- Supply shocks cause a dilemma in MP
  - Trade-offs may be larger in Emerging Markets

**Methodology:**
- Empirics: Analysis via Bayesian PVARs & Short-run identification.

**Results:** After a temporary TFP shock ($\uparrow a$)
- EM: Monetary policy is procyclical ($\downarrow r$).
- Fixed Exchange rate and more open EMs are more procyclical.
Dilemma of supply shocks

• What is a supply shock?
  A reduction in the cost of production due to lower input costs or improving technology. Ocampo and Ojeda-Joya think on the latter.

• MP Dilemma after a supply shock: Not stable Phillips curve
  \[ \pi_t = E \pi_{t+1} + \kappa (y_t - y^n_t) + u_t \]  (1)

• Ocampo and Ojeda-Joya think on shocks to \( y^n_t \)

• But, are all supply shocks equally problematic?

• In general, \( u_t \) is more problematic than \( y^n_t \). (Galí and Gertler(1999)).

• Shocks to technology (or shocks to \( y^n_t \rightarrow r^n_t \) ) may not be problematic if the central banks track adequately the natural rate of interest, \( r^n_t \). e.g
  \[ i_t = r^n_t + \phi \pi E_t \pi_{t+1} + v_t \]  (2)
How does the natural rate respond to a supply shock?

- Consider a simple close economy model determination. From the Euler equation:

\[ r^n_t = \rho + \sigma E_t (y^n_{t+1} - y^n_t) \]  
\[ y^n_t = a_t \]  

- Given the behavior of \( a_t \):
  - Permanent change in \( a_t \) $\Rightarrow \uparrow r^n_t$
  - Transitory change in \( a_t \) $\Rightarrow \downarrow r^n_t$

- Ocampo and Ojeda-Joya think the latter is happening. Thus, $\uparrow a_t \Rightarrow \downarrow r^n_t \Rightarrow \downarrow i_t$

- In other words, Ocampo and Ojeda-Joya is showing us the real interest rate in EM is moving in the right direction of a temporary TFP shock. Central banks are doing what they should do.

- Results under Fixed Exchange rate & more financially open economies confirm this result.
Why we do not see this in developed economies?

Database of Global Economic Indicators

**Short-Term Official/Policy Rates**


SOURCES: Database of Global Economic Indicators; Haver Analytics.

Figure:
Conclusion

- Nice paper and with a very interesting question.
- However, maybe monetary policy is reacting as it is supposed to do.
Additional comments

- Why not working in levels instead of growth rates. A shock to a growth rate is a permanent shock to the level.
- Working with Solow residuals may be not good. It may be picking up demand shocks (Evans 1992, Basu and Kimball 1997)
- Regarding the identification: better way to recover TFP is to use the Max-Share strategy (Uhlig 2003)