CENTRAL BANK OF THE REPUBLIC OF TURKEY

Emergence in the Post-Crisis World: Increasing Asymmetries between Advanced and Emerging Economies

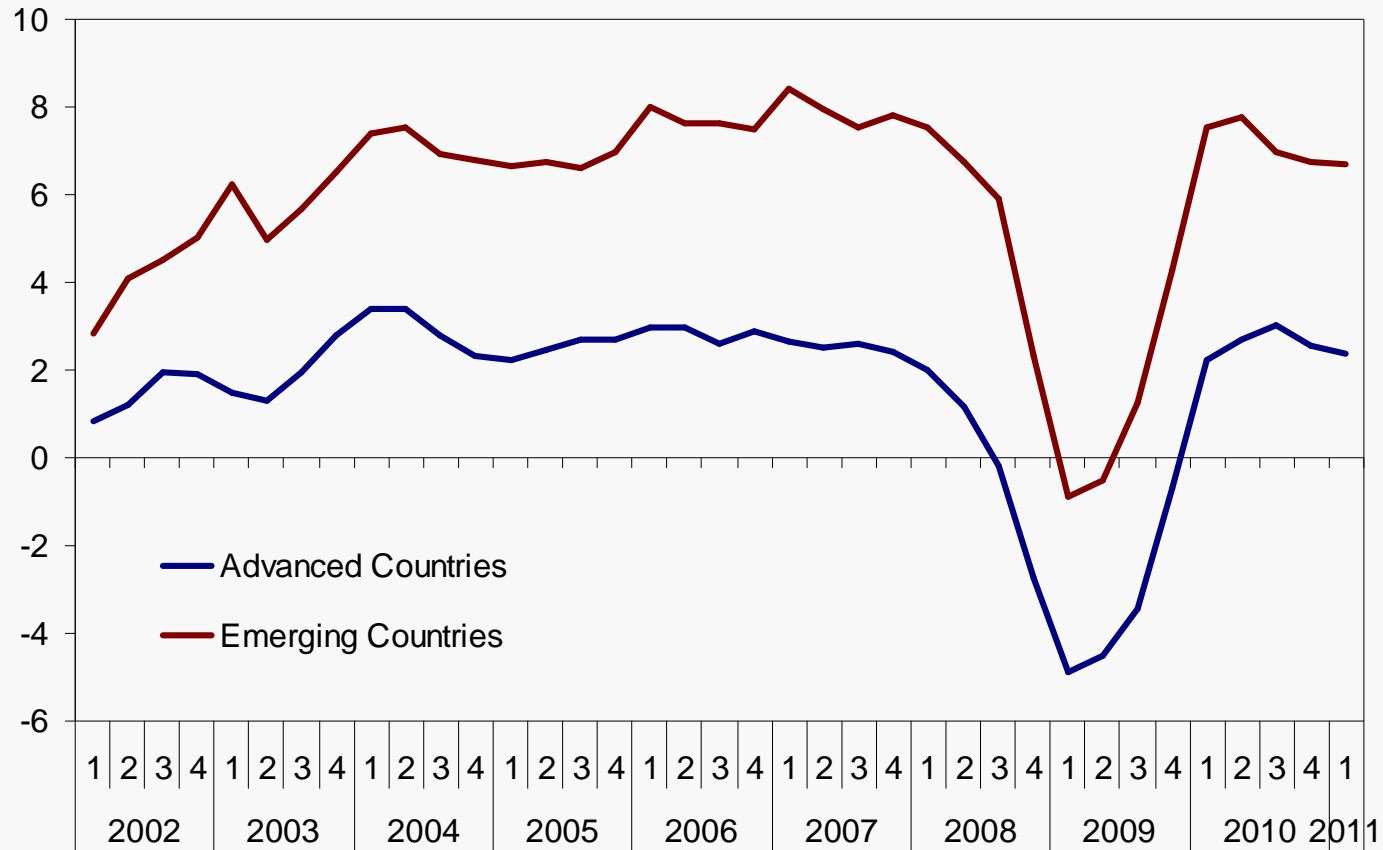## Mehmet Yörükoğlu
Deputy Governor

RBWC Conference, July 2012

Increasing Asymmetries between Advanced Economies and Emerging Economies

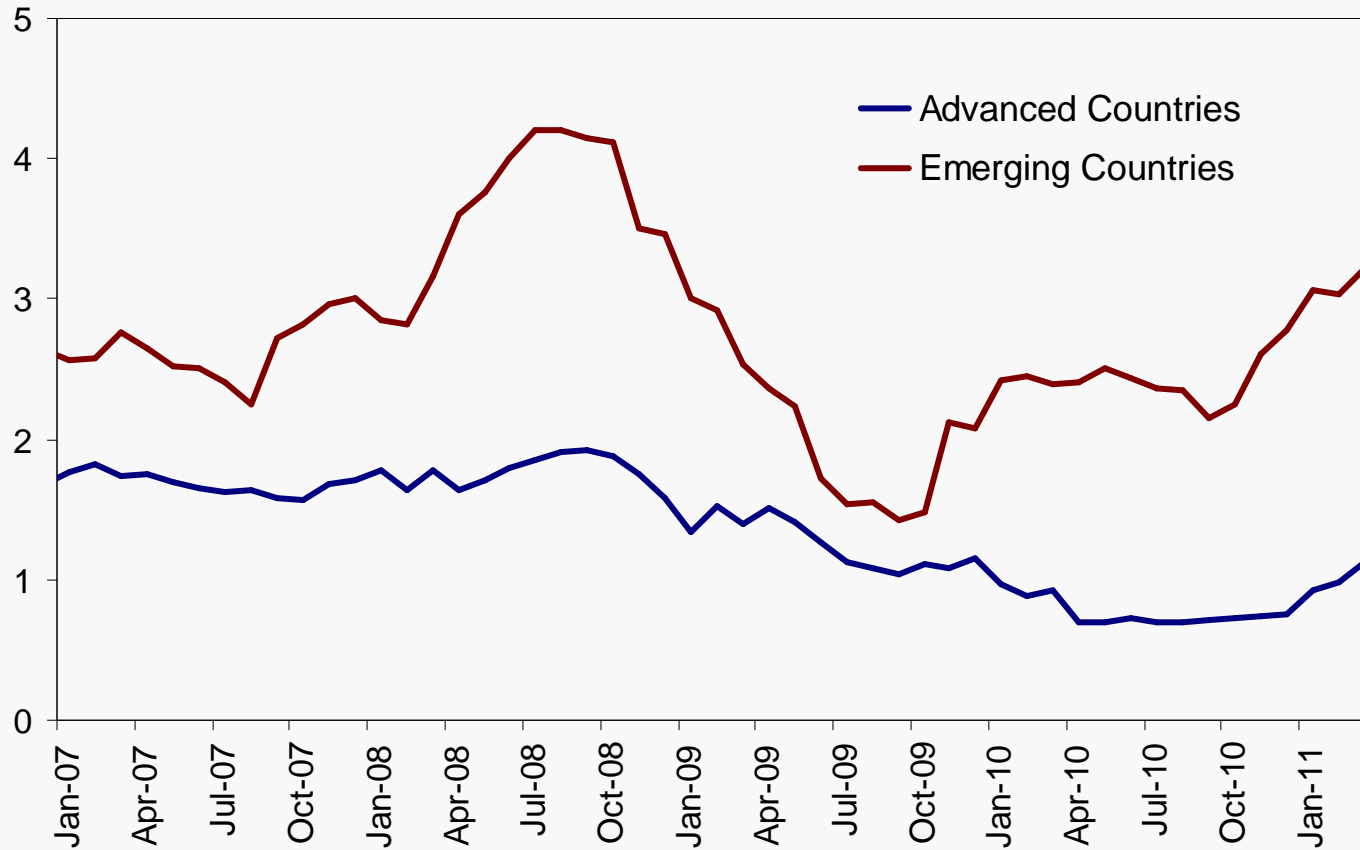TÜRKİYE CUMHURİYET MERKEZ BANKASI

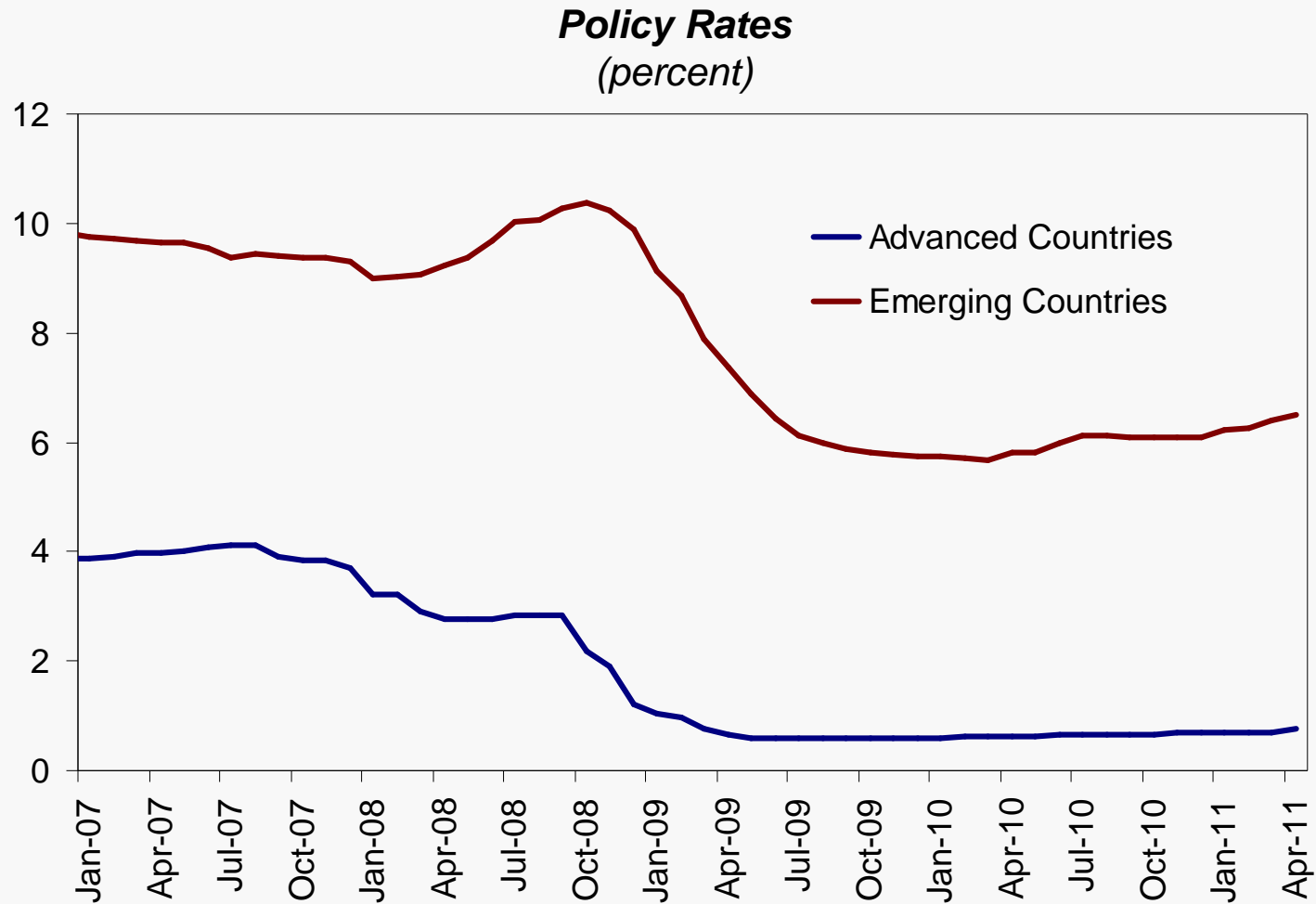# Growth Differential

Growth Rates
(annual change)

Source: Bloomberg, CBRT

Inflation Differential

Core Inflation
(annual change)
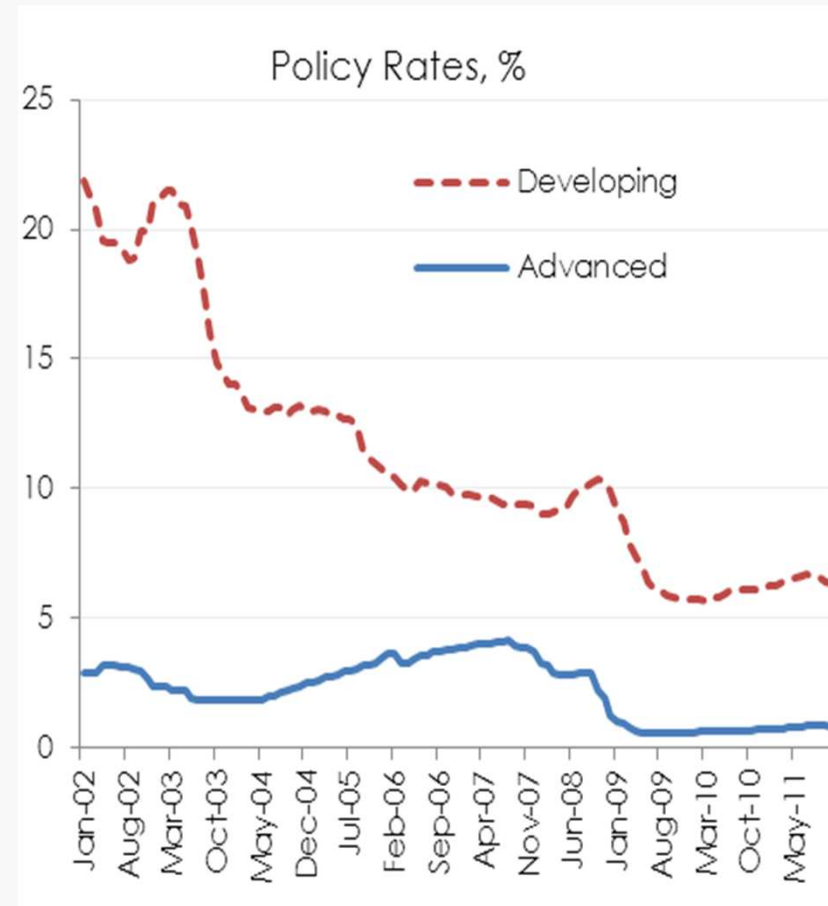

Source: Bloomberg, CBRT
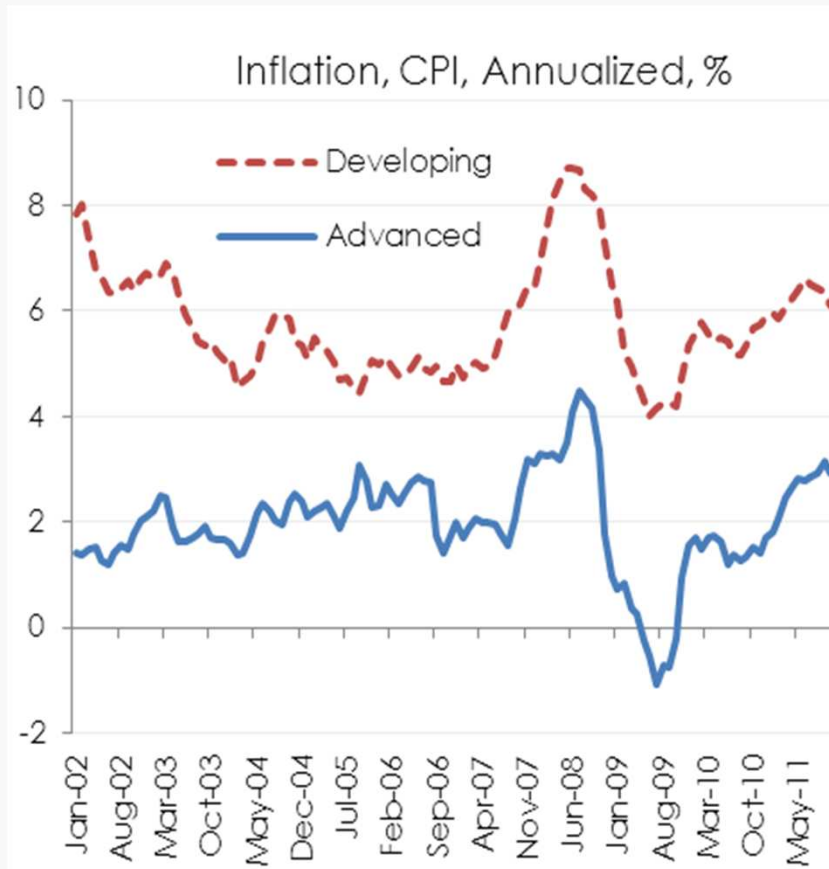
Policy Rate Differential

Policy Rates
(percent)

Source: Central Banks, CBRT

TÜRKİYE CUMHURİYET
MERKEZ BANKASI

There has been almost a constant wedge in average inflation and policy rates ...

Differences in Inflation and Monetary Policy

- **Asymmetry in consumer baskets between advanced and EMEs.**
  - Food is more significant in the baskets of EMEs.
    - Food prices have potential to rise due to
      - Rapid growth of EMEs,
      - Lack of sufficient agricultural productivity growth in EMEs and developing economies,
      - Rapid employment shift from agriculture to industries in EMEs.
  - High-tech consumer products are more significant in the consumer basket of advanced economies.
    - Rapidly declining price and increasing quality of especially CIT products.
 - ***New-good bias***

Differences in Monetary Policy

- Convergence dynamics together with the consumer basket asymmetries;
  - Inflation in EMEs and has a relatively upward pressure;
  - EME Central Banks are more concerned about inflation whereas advanced countries' Central Banks are more concerned about growth.
  - In EMEs and developing economies,
    - Tighter monetary policy and fiscal policy
    - Exchange rate appreciation
    - Higher inflation targets

TÜRKİYE CUMHURİYET
MERKEZ BANKASI

New-good bias

Price Profile after Innovation
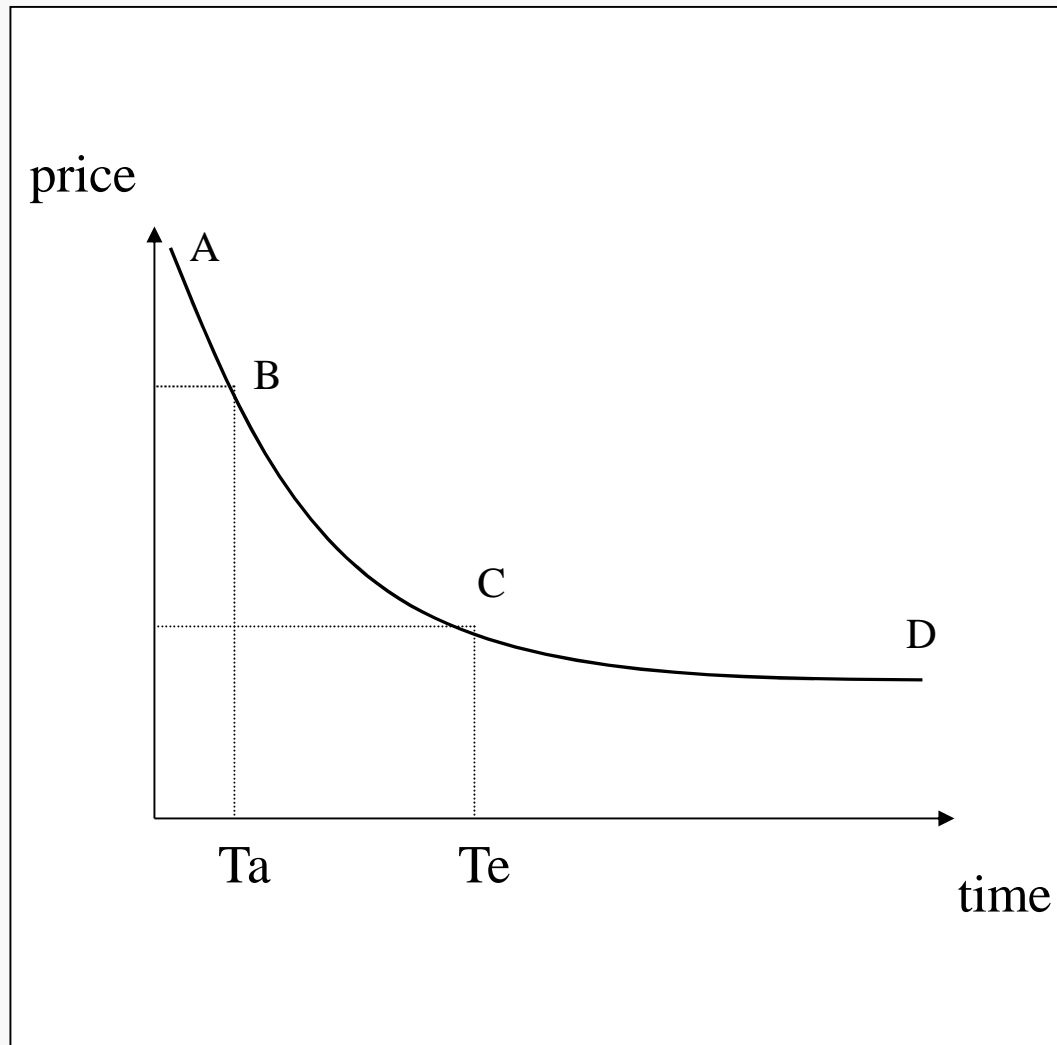
- New good's price declines rapidly after introduction. (curve AD)

- It enters into the CPI baskets of the advanced and developing economies at times Ta, and Te, respectively.

- The price decline along the curve (BC) is not accounted in EME's inflation measurement.
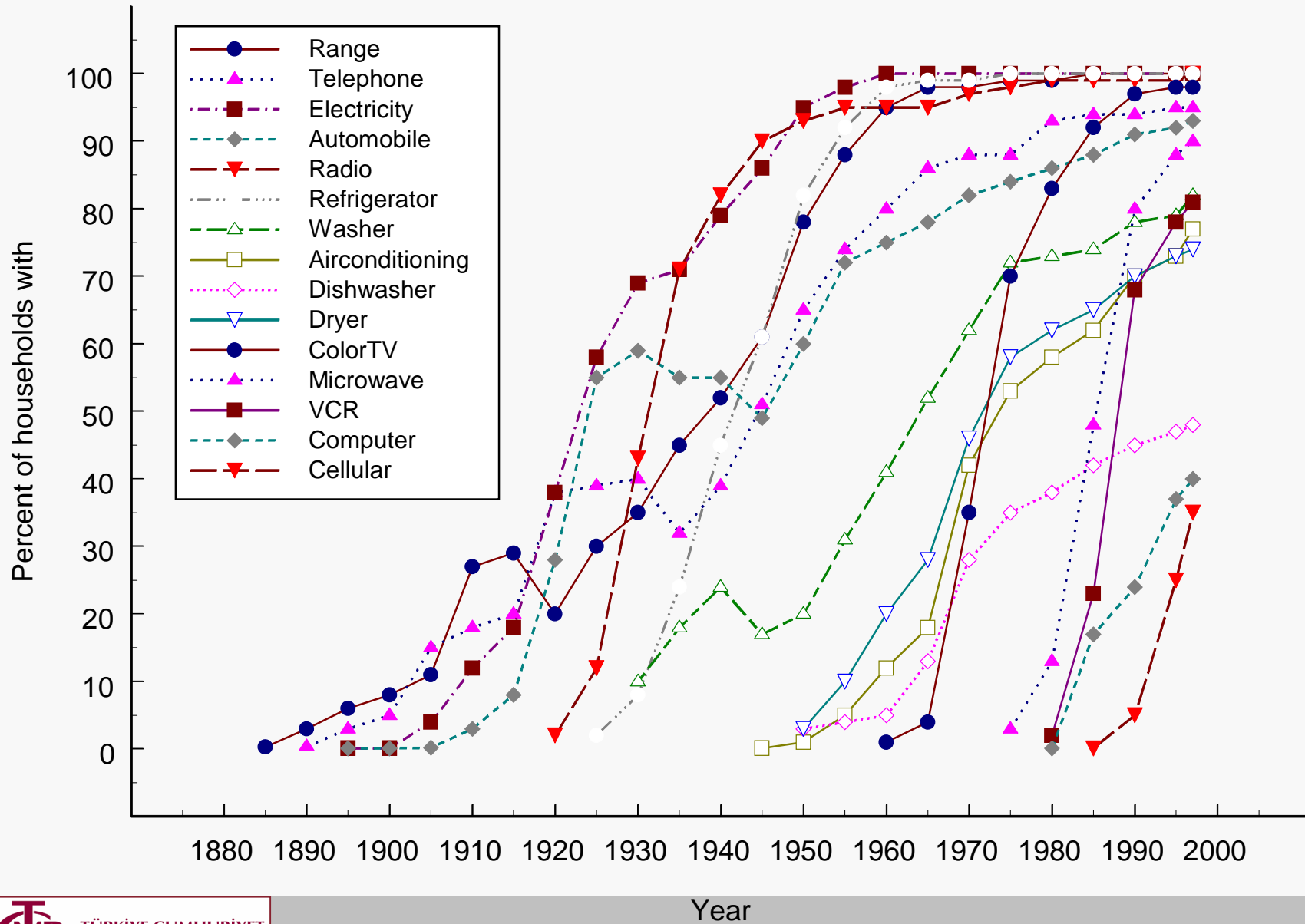
New-good bias

- In the last couple of decades:

  - Growth is mainly through innovation of new goods, i.e. Speed of innovation has increased;

  - Diffusion of new goods is faster;
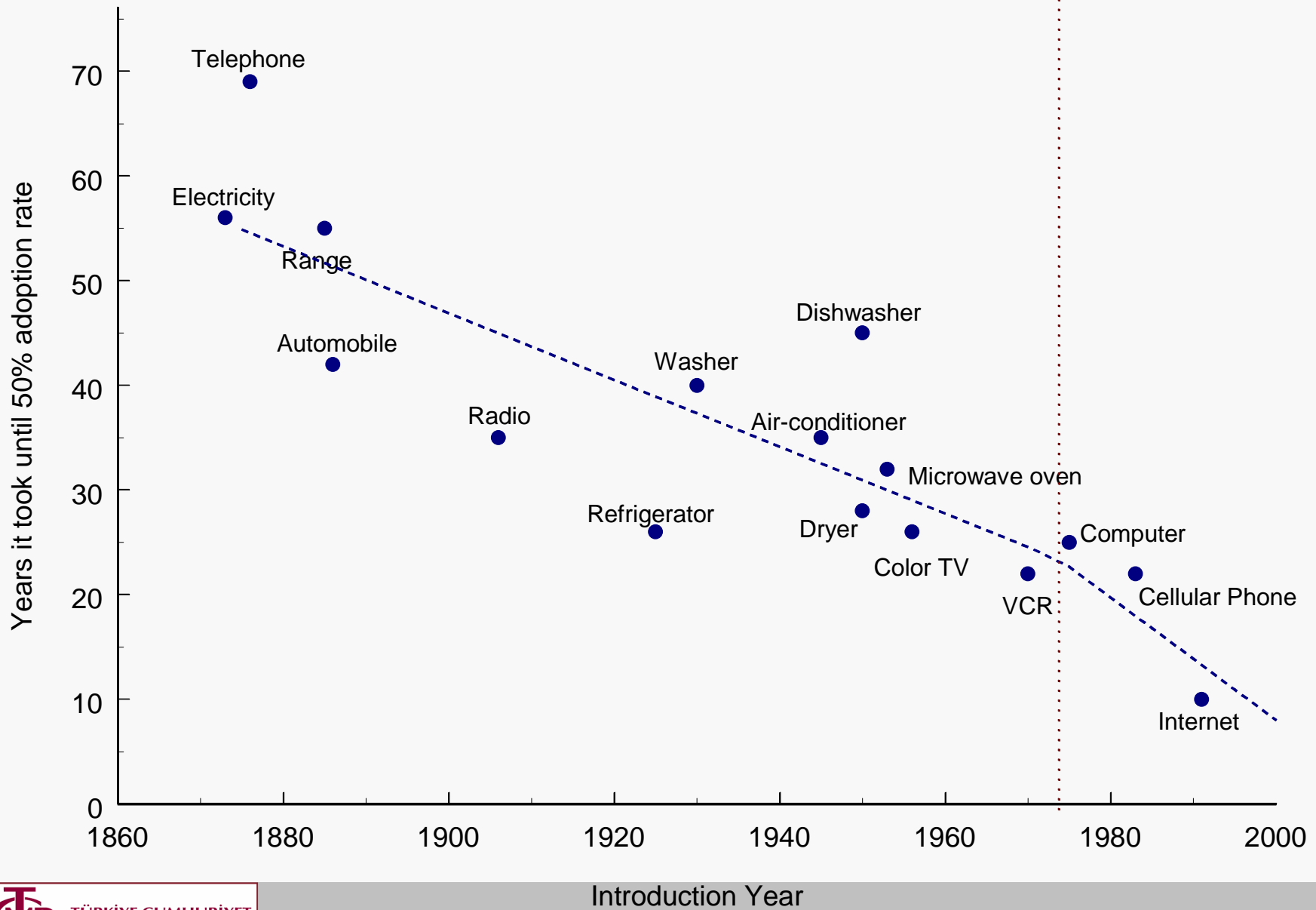
  - Price profile is steeper.

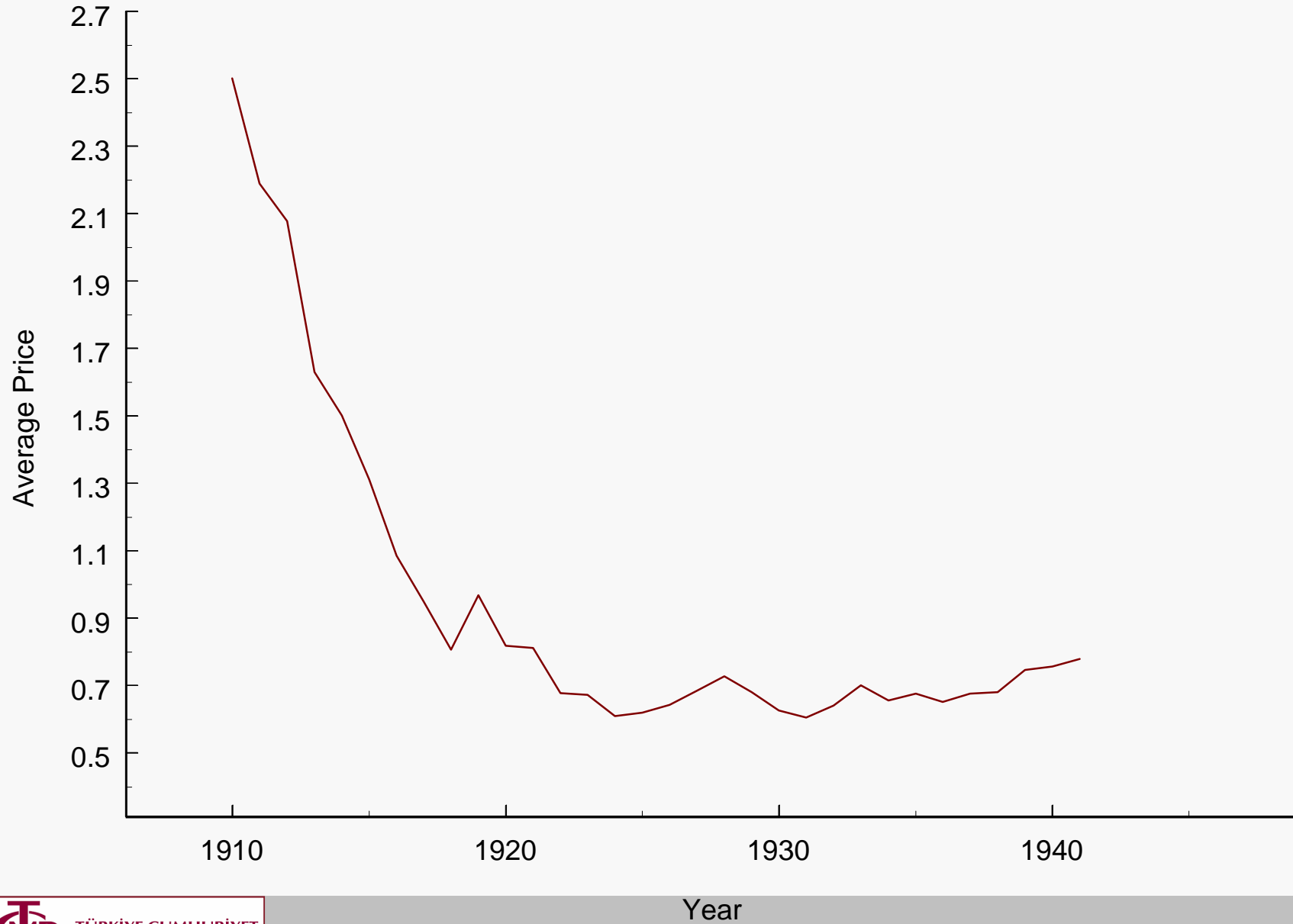 ➡ New-good bias has become more significant.
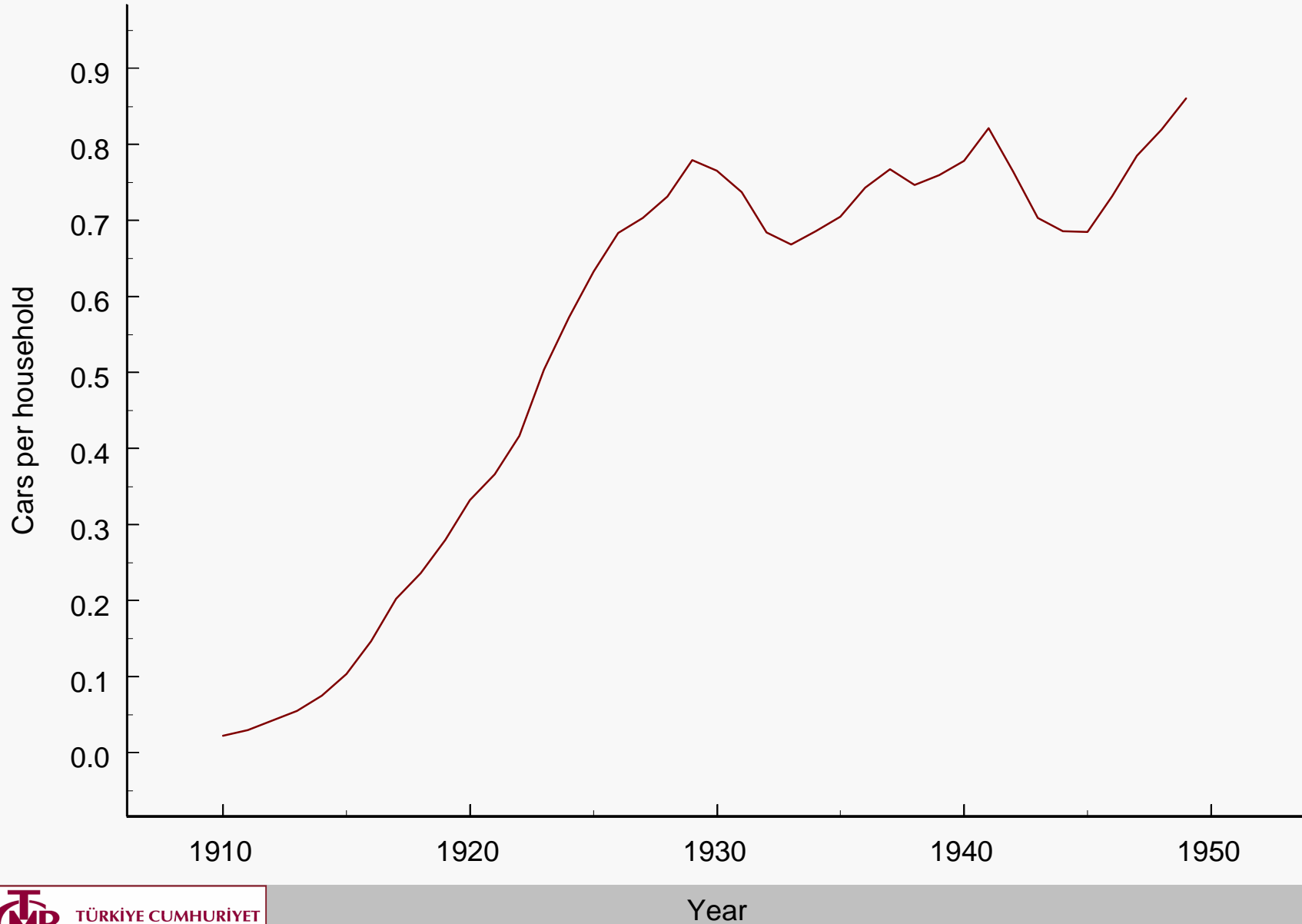
Diffusion of Products

Diffusion Half Lives

Years it took until 50% adoption rate vs. Introduction Year

Telephone, Electricity, Range, Automobile, Radio, Refrigerator, Washer, Dishwasher, Air-conditioner, Microwave oven, Dryer, Color TV, VCR, Computer, Cellular Phone, Internet

TÜRKİYE CUMHURİYET MERKEZ BANKASI

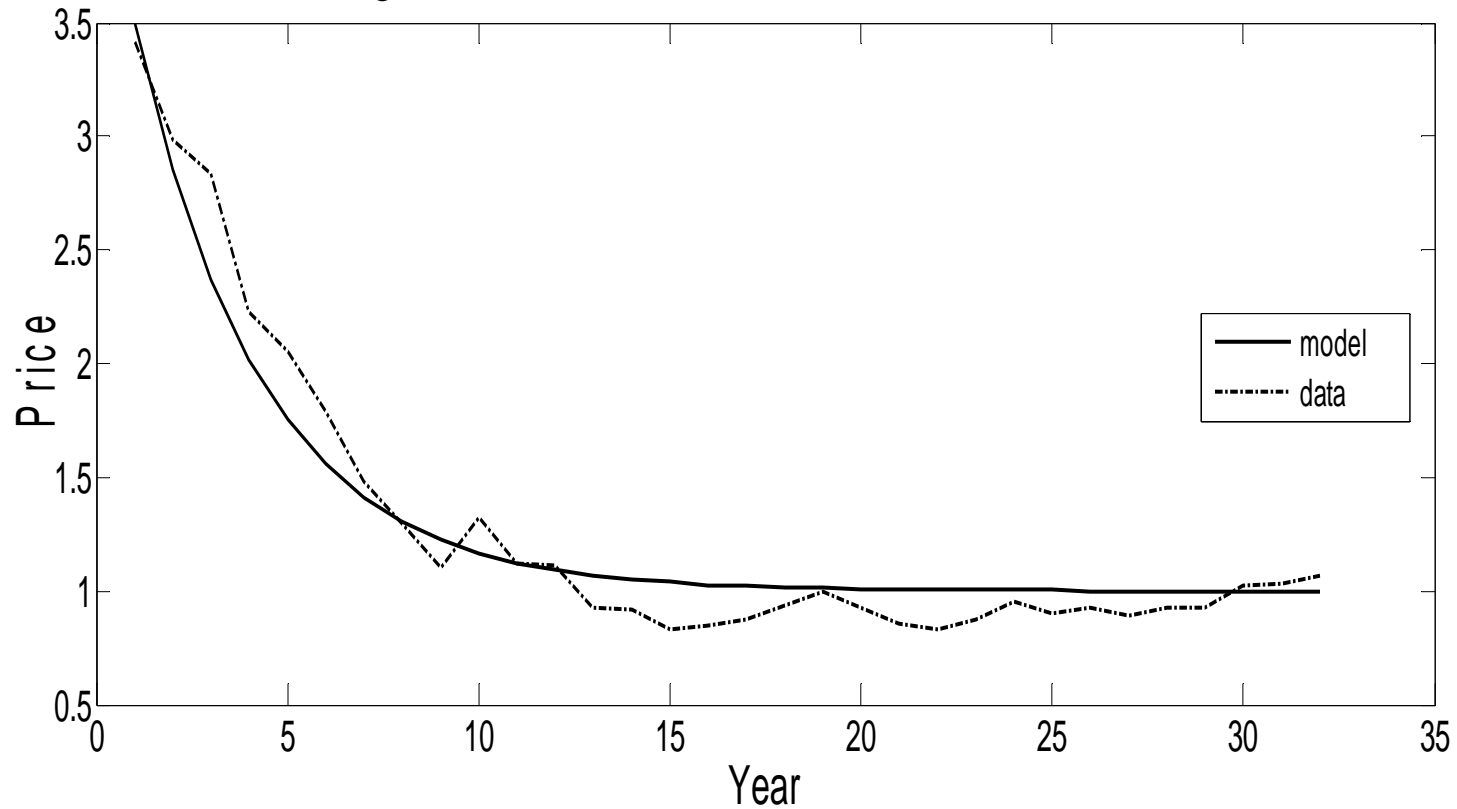Average Price of a New Car (in 1929 ($000))
(Nonhedonic)
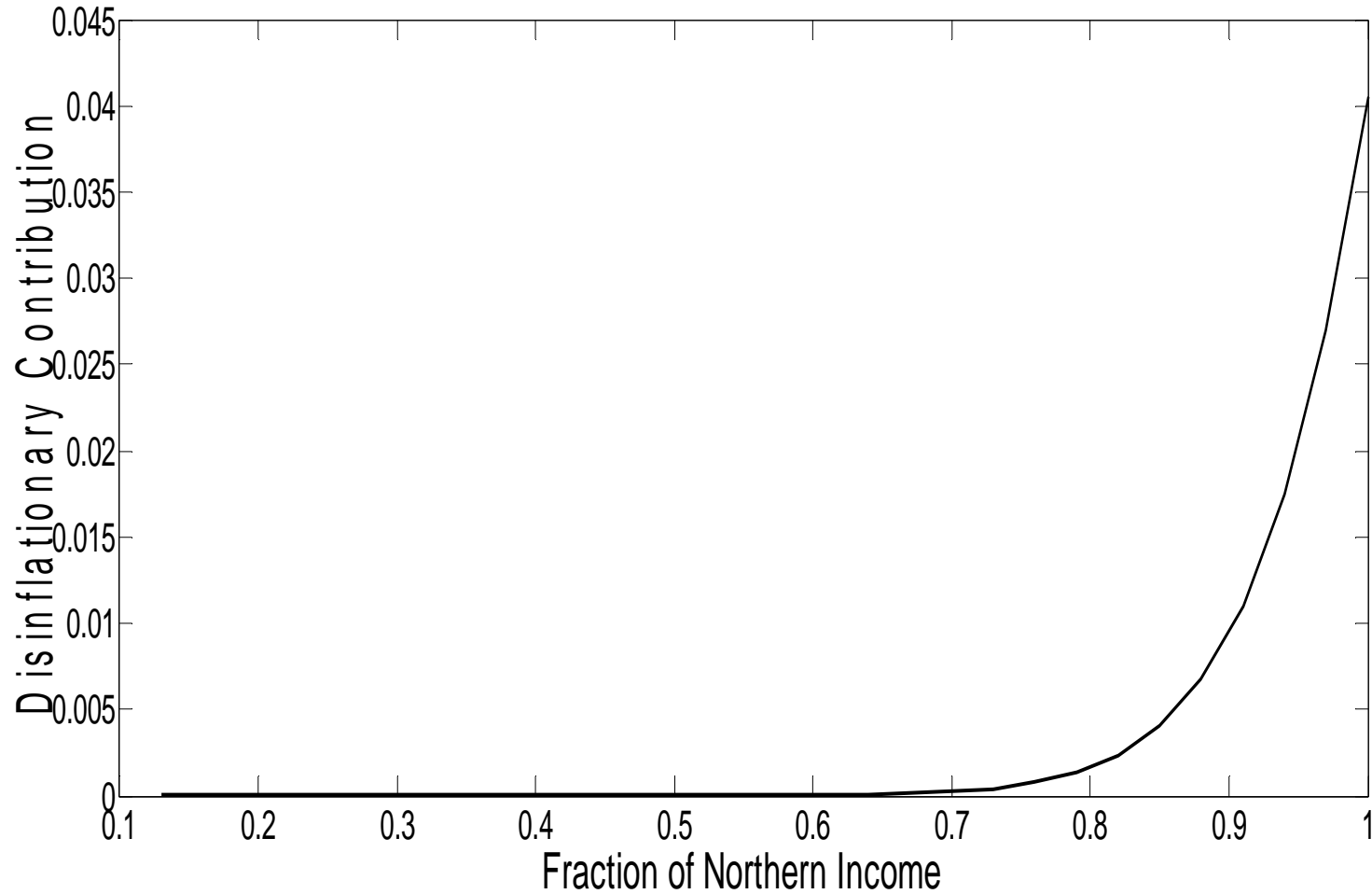
Number of Cars per Household

Price Profile after Innovation for Automobiles

Figure 11   Price Profile after Innovation

Disinflation Pressure due to Innovation

Figure 8   Disinflation Pressure from Innovation

Consequences

Because of consumption basket differences and the new-good bias;

- – Measured inflation in emerging economies is relatively higher;
- – Emerging economy central banks need to employ tighter monetary policy;
- – Significant appreciation pressure on emerging economy currencies.

As a result,

⟹ i) except the naturel resource rich ones, EMEs face high current account deficit, and as a result are subject to potential financial stability challenges.

ii) Convergence slows down.

What can be done ...

Compared to advanced economies, EMEs should employ

- higher inflation targets,
- multi-tool monetary policy,
- macroprudential tools,
- tight fiscal policy.

Real exchange rates and public debt