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Nominal GDP Targeting for Developing Countries

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Abstract

Interest in nominal GDP (NGDP) targeting has come in the context of large advanced economies. Developing countries are better suited for it, however, in light of big supply shocks and terms of trade shocks, such as monsoon rains and oil import price shocks in the case of India. Under annual inflation targeting (IT), the full impact of adverse supply shocks is felt as lost real GDP. NGDP targeting automatically accommodates such shocks, while retaining the advantage of anchoring expectations. We derive the condition under which NGDP targeting would dominate other regimes such as annual IT, to achieve objectives of output and price stability. We estimate key parameters for the case of India and conclude that the condition may indeed hold.

JEL numbers: F41, E52

key words: central bank, developing, emerging markets, GDP, income, India, inflation, IT, monetary policy, monsoon, nominal, shock, supply, target, terms of trade

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