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Explicit fiscal and monetary policy interactions in a small open economy

(2018) *Proceedings of the 31st International Business Information Management Association Conference, IBIMA 2018: Innovation Management and Education Excellence through Vision 2020*, pp. 7035-7043.

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Abstract
The issue of fiscal and monetary policy interactions has become relevant arising from economic events like the formation of the European Monetary Union and the aftermath of the global financial crisis. This study characterizes the nature of fiscal-monetary interaction and gauges its joint transmitted effect on inflation and output in Nigeria. The interactions are examined by calibrating and simulating a New Keynesian Dynamic Stochastic General Equilibrium (NK DSGE) model that includes an interaction effect equation. The explicit policy interaction variable is essentially relevant to quantify the joint macroeconomic effect of mixing fiscal and monetary tools in an economy. The study found that both fiscal and monetary policies interact as strong complements. This means that when one policymaker implements the expansionary measure, the other policymaker corroborates this action using expansionary policy. The common variable that explicitly captures the interaction between fiscal policy and monetary policy shows that the joint process of both policies has a weak effect on output and inflation. This implies stabilization policies are suspected to be insignificant in accounting for the outcomes in output and inflation in Nigeria.

Author Keywords
DSGE; Fiscal and Monetary Policies; Policy Interactions

Index Keywords
Expansion, Information management, Public policy, Stochastic models, Stochastic systems; DSGE, Fiscal policies, General equilibrium, Global financial crisis, Interaction effect, Monetary policies, Policy interaction, Stabilization policies; Economics

2-s2.0-85060809142
Document Type: Conference Paper
Publication Stage: Final
Source: Scopus