

Comments on Faust's

Is Applied Monetary Policy Analysis Hard?

Some of Jon's Key Questions

- What roles should models play in applied monetary policy?
- How should models be evaluated? (What is progress/regress?)

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(Type-A Analysis)
- Answer 2: Progressively more “sophisticated” models that help policy makers determine *good* policy.
(Type-B Analysis)

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Answer 2 raises another question:

How can judge whether models are useful?

Jon's Guidelines:

Models may be useful because they

1. Help refine economic intuition
2. Produce accurate reduced form forecasts
3. Serve as repository of a baseline view of the world and provide a common language.

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What about VARs?

Compared to 1980 Alternatives

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- Common Language:

- IRFs, VDs, (block-exogeneity tests) for summarizing dynamics

- Alternative linear descriptions: spectra, cross spectra, autocovariances, distributed lag coefficients

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- IRFs, VDs, (block-exogeneity tests) for summarizing dynamics

- Alternative linear descriptions: spectra, cross spectra, autocovariances, distributed lag coefficients
 - nonlinearities
 - instabilities

- VAR Forecasts

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- Problem of too many parameters

- Shrinkage

- Index/Factor constraints

Structural inference

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○ **structural shock identification**

- invertibility
- temporal aggregation
- lag length restrictions
- contemporaneous restrictions
- omitted variable bias

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- **interpretable feedback rules and the role of expectations**

- Formal Policy Analysis

- **Historical analysis** – which “shocks” were important?

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- **Policy counterfactuals**

- Choosing shock paths

- Choosing new feedback rules

Summary: Jon's Guidelines:

1. Refining economic intuition
2. Reduced form forecasting
3. Repository of baseline view of the world (common language, or springboard)