

Impact of International Monetary Policy in Uruguay: A FAVAR approach by Elizabeth Bucacos (BCU) BCRP-CEMLA-ECB-FRBNY

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This paper

- Specifies and estimates a Factor Augmented Vector Autorregressive (FAVAR) model for the Uruguayan Economy for the period 1995Q1-2014Q4.
- The main purpose of this empirical exercise is to quantify the dynamic macroeconomic effects for the Uruguayan Economy derived from an increase in the International Policy rate, a shock that can be related with the recent normalization of Monetary Policy in the US.
- The author considers external and domestic variables and identifies an external monetary policy shock with both recursive and non-recursive schemes. The main motivation is the vulnerability of the Uruguayan economy due to dollarization.
- The author performs an extension related with the inclusion of block exogeneity assumptions.
- The author finds that a rise in 230 basis points of the FFR drops Uruguayan output growth rate by 0,4% on impact.

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Main comments and suggestions I

- Three factors are usually associated with the Empirical Finance literature (yield curve models). In this new context, it would be useful to see the scree plot (sorted eigenvalues) in order to confirm the variance proportion explained by these three factors.
- On the other hand, it would be better to either:
 - ▶ Use variables that are similar each other prior to the computation of factors.
 - ▶ Use a different factor for each type (or group) of variables (e.g. fiscal variables, interest rates, etc.).
- Given the quarterly frequency, the sample size is not so large (1995-2014), and therefore one possible suggestion is to use prior information as in a Bayesian context: Litterman (1986) among others. This might reduce the uncertainty observed in the impulse responses. **Which is the appropriate period to evaluate the normalization of US policy?**

Main comments and suggestions II

- Gibbs Sampling (MCMC) method could also help to compute the confidence intervals in this exercise, especially for the Block exogeneity assumption.
- Instead of a non-recursive approach, I would suggest a simple sign restriction identification for the contractionary foreign monetary policy.
- Instead of using the shadow rate (which has some measurement error problems), another possibility is to include both the US short term rate and the *spread* between long and short term interest rates.