

**Discussion of " Questioning the puzzle:  
fiscal policy, real exchange rate and  
inflation"**

Alexander Kriwoluzky

Marseilles, July 5 2019

## The paper

- ▶ investigates the effects of fiscal policy on inflation and the real exchange rate
- ▶ employs a Proxy-SVAR with Ramey's military news variable
- ▶ finds that Inflation increases and real exchange rate appreciates

# Does the exchange rate regime matter?

Born, Jüssen, Müller (JEDC, 2013)

- ▶ in a floating regime monetary policy adjusts nominal interest rates one-for-one for an increase in inflation
- ▶ increase in real interest rates leads to crowding out of private consumption
- ▶ monetary policy constrained in a fixed exchange rate regime
- ▶ government spending multiplier are larger under fixed exchange rates

## Proxy variable – key for the results

- ▶ relevance condition: instrument correlated with the structural shock
- ▶ exogeneity condition: instrument should only contain information about the structural shock
- ▶ Proxy-SVAR model can only be estimated if MA-process is invertible

## Relevance condition

Stock and Watson (2012), Lunsford (2016)

- ▶ project instrument on reduced form shocks
- ▶ test strength of proxy variable
- ▶ exact critical values provided by Lunsford (2016)

## Exogeneity condition

Test exogeneity following Miranda-Aggripino and Ricco (2018):

- ▶ exogenous proxy delivers stable impact responses – even if the VAR model is misspecified
- ▶ compute impact responses for different VAR model specifications
- ▶ preferable employ estimated shocks from a DSGE as benchmark
- ▶ provide Box-plots

# Invertibility of MA-process

Stock and Watson (EJ, 2018)

- ▶ structural MA-process invertible, if structural shocks can be linearly determined from current and lagged observations
- ▶ if MA-process invertible LP-IV and impulse responses of Proxy-SVAR are consistent
- ▶ if MA-process is not invertible LP-IV are still consistent, Proxy-SVAR impulse responses are not
- ▶ test for invertibility of MA: Hausmann-type test with null hypothesis that MA-process is invertible

## Conclusion

Very interesting exercise and promising paper –  
thanks for inviting me to discuss it!