The basic identifying assumption underlying news driven models is that technology is driven by two shocks, one being the unanticipated technology shock and the other being the news shock, where the news shock doesn't have an impact effect on technology but rather portends future changes in it. This paper proposes and implements a novel VAR-based approach that generates the set of models consistent with the latter identifying assumption. The method is applied to investment-specific technology (IST) where it is shown that favorable IST news shocks raise output, hours, investment, and consumption, and account for the majority of their business cycle variation. Moreover, these shocks explain the bulk of the long-run variation in IST.

Nadav Ben Zeev
European University Institute
(EUI)

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Abstract

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