Discussion of
Measuring the Natural Rate of Interest:
A Note on Transitory Shocks
by Kurt F. Lewis and Francisco Vazquez-Grande

C. Cantore\textsuperscript{1}

\textsuperscript{1}Bank of England, Centre for Macroeconomics and University of Surrey

XXV Meeting of the Central Bank Researchers Network
Banco Central del Uruguay
28 October 2020
Highlights of the paper

- **What this paper is about**: measuring $r^*$. 

- Usually done by assuming two main drivers:
  - $(g)$ aggregate supply shock which directly affects potential output;
  - $(z)$ aggregate demand shock

- **Contribution**: Using looser set of prior parameter restrictions in order to let the data determine the statistical properties of $r^*$, $g$ and $z$ ⇒
  - $z$ turns out to be **stationary** in contrast with previous literature;
  - This implies: (i) a **more volatile** $r^*$ and (ii) a **higher** $r^*$ after the GFC wrt what is commonly estimated.
Disclaimer: I am a theorist so my comments/suggestion will be driven/biased by that.

1. How do your results square with increasing evidence of permanent effects of (some) demand shocks?

2. What if $g$ and $z$ are correlated?

3. Cross country evidence?
Comment I: Hysteresis and persistent demand shocks

In principle there is no clear theoretical justification why both drivers of $r^*$, $g$ and $z$, need to be non-stationary processes. In fact, theory suggests that shocks to aggregate demand, such as fiscal or financial shocks, may weigh on aggregate demand only temporarily.

► This view is consistent with the tradition of treating growth and business cycle independently. However there is mounting evidence of hysteresis: the dependence of GDP levels on its history of shocks. [Cerra et al., 2020]

► Growing theoretical literature showing permanent effects of demand shocks. [Benigno and Fornaro, 2018]

► Evidence of permanent effects of monetary policy. [Òscar Jordá et al., 2020]
Comment II: Demand and Supply shocks loops

- Covid-19 shock generated interest in modelling feedbacks and loops between supply and demand shocks. [Fornaro and Wolf, 2020], [Guerrieri et al., 2020]

- Can you generalize the model to allow for this?
Comment III: Cross country evidence?

- Are your results and implications for $r^*$ specific to the US or do they apply to other advanced economies?

- Adding cross country evidence would be interesting and also constitute a cross check given that the available evidence so far points towards a similar pattern for advanced economies. [Del Negro et al., 2019]
Conclusions

▶ Really enjoyed reading the paper.

▶ Extremely relevant for current policy discussion.

1. Compare and contrast your results against recent evidence of hysteresis.

2. Can you generalize your model to allow for demand-supply loops?

3. Cross country evidence.


