Comments on

Uncertainty Fluctuations: Measures, Effects and Macroeconomic Policy Challenges

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Motivation

- 2 papers: literature review & analytical paper (theoretical & empirical) – quite an impressive piece of work

- Research questions:
  - How does uncertainty impact the economy?
  - Do uncertainty shocks always matter for business cycles?

- Policy relevant:
  - When should stabilization policy be implemented?
  - Management of expectations

Methodology and main findings PB

- Literature review on uncertainty:
  - What uncertainty? How to measure it?
  - Channels through which it impacts the economy
  - Implications of uncertainty for policy makers?

- Three main findings:
  - Macro-policies can stabilizing policy-related uncertainty
  - Financial regulation should reduce financial uncertainty
  - The effectiveness of stabilization depends on the state of uncertainty

General comments PB

- **Uncertainty**:
  - In finance, uncertainty different from risk:
    - no distribution of probability, no PRICING! This happens in financial crises
  - If there is no distinction => potential issue: uncertainty, because unobservable, is "overused"(misused?).
  - Example: Impact of uncertainty on investment
    - "Wait and see" not new in the literature and not necessarily linked to crisis – or uncertainty shocks.
    - Investment maybe postponed because of low returns: Compensation for the risk is insufficient. How do we distinguish the two situations? From a policy perspective, implications are different

General comments PB (II)

- **Renewed interest in uncertainty**
  - After GFC: episode of high (systemic?) uncertainty. We did not see it coming and not know how it would play out
    - Financial markets development can affect largely the real economy
  - Global common factor: globalization and financial linkages. Borders less relevant, i.e. country specific variables less relevant?
  - Changes in the underlying structure of the economy. Transmission mechanisms may work differently: is this uncertainty or 'wrong' model/assumptions?
  - The "raise" of politics: Brexit, Trump, popular discontent – unpredictable. Serious issue for economists. This is 'true' uncertainty, we cannot do much

General comments PB (II)

- **Renewed interest in uncertainty**
  - Huge amount of data and information available
    - (very) High frequency data financial markets
    - Written pieces of any kind can be systematically analysed to identify common factors and trends
    - Other example
  - In theory, it should reduce uncertainty: set of information to build expectations is larger
  - In practice: what if noise is increased? Issue about information is selection of the relevant one.
    - Text analysis: robustness purpose OK, inference requires caution
    - High frequency data good for profit-making not for macro-stabilization: real economy is much slower than financial markets.

Conclusion PB

- In the three conclusions uncertainty is referring to more specific concepts.
  - First: EPU shocks. From the literature presented unclear who should stabilize what? Indicators of EPU very noisy. This is "country risk".
  - Second: Financial uncertainty = financial instability, which is the target of macro-pru. policies. Monitoring even more relevant in tranquil periods
  - Third: State of uncertainty = state of the economy (financial cycle, constrained agents)

Methodology and main findings WP

- Research question:
  - Do Uncertainty Shocks Always Matter for Business Cycles?

- Methodology:
  - Inputs from MS-SVAR (IRF) into a MS-DSGE model

- Findings:
  - Fluctuations in uncertainty weaken policy effectiveness
  - Non-linear effects reinforce the role of agents' beliefs in shaping business cycles

General comments

- Standard DSGEs:
  - equilibrium models, not for really business cycle
  - dynamics are usually induced by frictions and they have usually small magnitude, we are close to the steady state
  - shocks are usually AR(1) process, so no abrupt changes
  - Expectations are rational: based on 1st moment - average

General comments

- Changes to standard DSGE:
  - Stochastic volatility and parameters follow a MS process
  - Financial frictions exists and different across regimes- monitoring costs higher
  - Expectations depend on the regime: agents know the probability of the MS process
    - This is a key hp: agents know probability of changing regime (assigned by the MS process). This has an amplification effects
- To what extent this setting can be applied outside large financial crisis context? How far is this from the equilibrium?