

News versus Sunspot Shocks in a New Keynesian Model

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This paper develops a simple new keynesian monetary model that allows to study, within a unified framework, the effects of news and sunspot shocks. By providing an analytical solution to the model, this paper gives a clear characterization of the full set of rational expectation solution, and clear cut conditions under which each type of shock have an effect on the dynamics of the economy. As well known , when monetary policy is aggressive vis à vis inflation, sunspot shocks do not matter and the response of the economy to a news shock is unique. When monetary policy does not respond enough to inflation (Taylor principle), both type of shocks exert an effect on economic dynamics. Interestingly, indeterminacy leads non uniqueness of the effects of news shocks. A strong implication of this latter result is that the dynamics induced by news and sunspot shocks can be observationally equivalent. In other words, news shocks and sunspot shocks may not be identifiable.

I liked the paper a lot. This is simple, clear, well written and makes the point very efficiently. The most prominent result is clearly the lack of identification of sunspot and news shocks: One may not be able to decide, based on the dynamic properties of an economy as obtained from a VAR, to decided whether shocks are fundamental or not. This clearly poses a challenge to part of the literature.

I therefore recommend the paper for publication.