

## Reply to referee report #1

Eilev Jansen and Tord Krogh, 30 August 2011

We appreciate the comments to our paper from referee #1 which are both relevant and interesting. Our response to the various points follows.

1. We agree that our unit roots tests are somewhat inconsistent with the main assumptions of the paper, in that we don't control for multiple breaks in the tests. This is probably something we should do in a revised version of the paper, although intuition tells us that this will only strengthen our arguments as it will probably make the appearance of I(2) variables less likely.
2. We do worry about mixing variables of different orders of integration, and hence we discuss the issue of cointegration to some extent, but the referee is indeed right that we do not treat the issue as extensively as in pure cointegration applications.
3. Whether the VECM is an appropriate model or not is largely an empirical question. We have chosen this model to remain close to Fernandez-Corugedo and Muellbauer (2006), but in future work we agree that alternative models should be tried out.
4. The role of misspecification is of course always an important concern. We do not know the answers to these questions as you always would prefer models without any signs of misspecification. As a reader will see, we have chosen to lay our results open to criticism on this point.
5. See point 4.

The referee is correct in pointing out that our results rest on a number of assumptions in order to making it possible to conduct the analysis. The few zero-restrictions that are imposed are in large part innocuous – there is one significant violation of our “priors”, based on institutional knowledge, but that coefficient can be well explained by the historical facts.

In general, the referee could possibly have considered granting us some credit for the novelties of our paper. It is original research and it provides positive results which can be evaluated on the basis of a separate documentation of regulations and deregulations in the Norwegian credit market 1970-2008, see Krogh (2010). That said, the quotation from the paper at the end of the referee report admittedly exaggerates the significance of our paper, and to be more in line with the rest of the paper it should perhaps be rephrased to read: “The importance of a credit conditions index is that it potentially permits the researcher to control for structural supply shifts in the credit market in empirical analyses. Our estimated trend should be considered as an important step towards providing such a tool.”

Needless to say -- as authors -- we would also have wanted even more robust results. However, we judge our estimates, and the clear-cut and fair presentation of its properties and weaknesses, to be an important step on the way to further improvements.

**References:**

Fernandez-Corugedo, E., and J. N. Muellbauer (2006): "Consumer Credit Conditions in the U.K." Working Paper 314, Bank of England, London.

Krogh, T.S.H. (2010): Credit regulations in Norway, 1970-2008, Reports 37/2010, Statistics Norway, [http://www.ssb.no/english/subjects/11/01/rapp\\_201037\\_en/rapp\\_201037\\_en.pdf](http://www.ssb.no/english/subjects/11/01/rapp_201037_en/rapp_201037_en.pdf)