

Report on

Financial Stress, Regime Switching and Macrodynamics: Theory and Empirics for the US, EU and Non-EU Countries

This is a very interesting paper. In it the author attempts to explain and analyze the output of a number of countries including the USA, a number of countries in the EU and also a few non-EU countries such as Canada and Japan, using fairly recent innovations in time series analysis. In particular the author attempts to explain the use of multi-regime vector auto-regressions (VAR). This technique may have been used in the physical sciences for some time but is fairly recent in economics (at least this reviewer has not seen it used earlier).

Overall the author has done a good job explaining what he/she has done, but I felt that the discussion was lacking in a few aspects. First I would like the authors to make clear what is the difference between the methodology that they are suggesting and the regular Markov switching models. Second I felt that the discussion lacked a little in a few places. For instance, I did not really understand what the author meant by “a receding decision horizon problem”. Furthermore I felt that a little bit further explanation of this point might have been warranted. In addition I did not fully understand what the author meant by the term “horizontal capital stock” on page 5. More importantly I could not see the difference between equation 3 and equation 6, I really would like this cleared up. The mystery in cleared up a little when it in revealed that $r(b_t/k_t)$ is a function, but I think that a lot more explanation is required. Also equation 10 looks the same as equation 6, I feel that here also a lot more explanation is called for.

There were a few other more minor points such as, the function φ was not defined at equation 3 (at least I could not find it). Also I could not find the definition of BEL on page 19, it may have been introduced but it was probably much earlier. I feel it is a good practice to re-define what a symbol means after a certain time even if it has been defined earlier, alternatively an appendix containing notation could be used.

I did not feel that the title of the paper really gave much idea of what the paper is about. I personally would prefer a title that focuses on the methodology being used.

Finally, there were a number of small corrections to the level of English. Please see the attached file for these.