

We thank the referee for their thoughtful consideration of our manuscript. Their review has given helpful guidance in improving the paper. To provide context for our responses we have reproduced the three main comments given by the referee in serif, each of which is followed by our response.

1. The introduction should highlight the contribution of the paper more clearly. In the current version, it is not directly clear how the paper contributes to the literature.

The contribution of this paper to the literature is that we have solved the *IS* puzzle. We will enhance the introduction as suggested.

2. In this vein, the empirical findings should also be explicitly compared to previous empirical findings.

The literature on the *IS* puzzle is small and the comparison we make to previous empirical findings can be considered exhaustive.

3. Please provide more information on the underlying data and the conducted estimation method.

We will enhance this aspect of the paper as suggested.

4. Is it really surprising that time-variation is an important issue. Some more thoughts in the conclusion would be helpful.

We agree that this is surprising. We will enhance the conclusion with additional thoughts as suggested.