What are the Effects of Monetary Policy Shocks?
Sign Restrictions and Endogeneity of Monetary Policy Actions

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Abstract

Uhlig (2005) proposed VAR models with sign restrictions on impulse responses, to identify monetary policy shocks without the price and the liquidity puzzles. Based on the method, Uhlig (2005) reported that effects of monetary policy shocks do not have a clear effect on output; neutrality of monetary policy shocks is not inconsistent with the data. A careful examinination of Uhlig (2005)'s results even show that contractionary monetary policy shocks might lead to, if any, a rise in output, instead of a fall in output and that the price level falls permanently but the monetary aggregate does not in response to contractionary monetary policy shocks. This paper suggests that the identifying restrictions imposed by Uhlig (2005) may not seperate exogenous monetary policy actions from endogenous, counter-cyclical, monetary policy actions to supply-side disturbances that change output and the price level in opposite directions. When more restrictions are imposed to exclude the effects of supply-side disturbances, the effects of monetary policy shocks look more conventional.

Keywords: Monetary Policy Shocks, VAR, Sign Restrictions, Supply Shocks, Endogenous Monetary Policy

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