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MONETARY POLICY SHOCKS, INFLATION PERSISTENCE, AND LONG MEMORY

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Abstract: Structural VAR studies on the effects of monetary policy actions do not usually take into consideration the observed persistence of inflation and many of the other variables included in the models. In this paper, we account for this issue by analyzing the effects of the monetary policy shock in a structural fractionally integrated VAR. Our main findings are: a) there is overwhelming evidence of long memory, with the traditional framework, decisively rejected by the data; b) allowing for long memory has strong implications for the analysis of the responses of the variables to non-systematic policy actions; c) typical VAR specifications lead to a misleading assessment of the importance of the monetary policy shock; d) the long memory properties of inflation remain stable across the usual sample splits in the literature, consistent with the view that long memory is an intrinsic property of inflation data arising in the construction of the price indexes. This result is robust to alternative specifications of the model.

Keywords: Fractional integration; FIVAR model; impulse response; variance decomposition

JEL Classification: E52, C32

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