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Uncertainty shocks, central bank characteristics and business cycles

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Highlights

- The article investigates how the impact of uncertainty shocks on output varies with central bank characteristics.
- To address endogeneity concerns, the models are estimated using Two Stage Least Squares.
- There is strong evidence that central bank independence reduces the adverse impact of uncertainty on output.
- The evidence on central bank transparency is mixed.

Abstract

This paper investigates the conjecture that central bank independence and transparency moderate the negative effect of uncertainty shocks on real output. To test this conjecture, the real GDP growth rate is regressed on the interaction terms between measures of central bank characteristics and the proxy for macroeconomic uncertainty, i.e. stock market volatility. To address potential endogeneity concerns, stock market volatility is instrumented in a Two Stage Least Squares model by plausibly exogenous natural disaster, terrorist attack, political coup and revolution shocks. The estimation results provide strong evidence that central bank independence reduces the adverse effect of uncertainty shocks. There is also evidence for the moderating

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