

1 Clark87

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The UC model of Clark (1987) is a generalisation of the HP-Filter (a local linear trend model) that can be expressed as an SSM taking the following form:

$$y_t = y_t^* + \tilde{y}_t \quad (1a)$$

$$\Delta y_t^* = g_{t-1} + \sigma_1 \varepsilon_{1t} \quad (1b)$$

$$\Delta g_t = \sigma_2 \varepsilon_{2t} \quad (1c)$$

$$a(L)\tilde{y}_t = \sigma_3 \varepsilon_{3t}, \quad (1d)$$

where the shocks $\{\varepsilon_{it}\}_{i=1}^3$ are assumed to be *i.i.d.* standard normal and mutually uncorrelated, with standard deviation σ_i and $a(L)$ is commonly assumed to be a stable AR(2), so that $a(L) = (1 - a_1 L - a_2 L^2)$. The only observable is y_t (generally 100 times) the log of real GDP and with the cycle (denoted by \tilde{y}_t) now allowed to be serially correlated, following a stationary AR(2) process. There are 3 shocks in the model.

The ‘*numbered*’ shock to ‘*named*’ shock mapping is:

$$\begin{bmatrix} \varepsilon_{1t} \\ \varepsilon_{2t} \\ \varepsilon_{3t} \end{bmatrix} = \begin{bmatrix} \varepsilon_t^{y^*} \\ \varepsilon_t^g \\ \varepsilon_t^{\tilde{y}} \end{bmatrix}. \quad (2)$$

2 Shock recovery SSM

2.1 SSM with lagged states

SSM

Kurz’s (2018) SSM has the following general form:

$$\text{Measurement : } Z_t = D_1 X_t + D_2 X_{t-1} + R \varepsilon_t \quad (3a) \quad \text{ssm1}$$

$$\text{State : } X_t = A X_{t-1} + C \varepsilon_t, \quad (3b) \quad \text{ssm2}$$

where $\varepsilon_t \sim MN(0, I_m)$, D_1, D_2, A, R are C conformable system matrices, Z_t the observed variable and X_t the latent state variable.

2.2 Clark87 SSM for shock recovery

To assess recovery, re-write the model in (1) in ‘*shock recovery*’ State Space Form (SSF). That is, collect all observables in Z_t and all shocks (and other state variables) in X_t to yield:

$$\begin{aligned} \Delta^2 y_t &= \Delta^2 y_t^* + \Delta^2 \tilde{y}_t \\ &= \sigma_1 \Delta \varepsilon_{1t} + \Delta g_{t-1} + \Delta^2 \tilde{y}_t \\ &= \sigma_1 \Delta \varepsilon_{1t} + \sigma_2 \varepsilon_{2t-1} + a(L)^{-1} \Delta^2 \sigma_3 \varepsilon_{3t} \\ \Leftrightarrow a(L) \Delta^2 y_t &= \sigma_1 a(L) \Delta \varepsilon_{1t} + \sigma_2 a(L) \varepsilon_{2t-1} + \sigma_3 \Delta^2 \varepsilon_{3t} \end{aligned}$$

$$\begin{aligned}
Z_t = & \sigma_1 [\varepsilon_{1t} - (2 + a_1) \varepsilon_{1t-1} + (1 + 2a_1 - a_2) \varepsilon_{1t-2} + (2a_2 - a_1) \varepsilon_{1t-3} - a_2 \varepsilon_{1t-4}] \\
& + \sigma_2 (\varepsilon_{2t-1} - a_1 \varepsilon_{2t-2} - a_2 \varepsilon_{2t-3}) \\
& + \sigma_3 (\varepsilon_{3t} - 2\varepsilon_{3t-1} + \varepsilon_{3t-2}),
\end{aligned} \tag{4} \quad \text{Z}$$

where I have made use of the fact:

$$\begin{aligned}
a(L)\Delta^2 &= (1 - a_1 L - a_2 L^2)(1 - L)^2 \\
&= 1 - (2 + a_1) L + (1 + 2a_1 - a_2) L^2 + (2a_2 - a_1) L^3 - a_2 L^4,
\end{aligned} \tag{5} \quad \text{expaL}$$

and $Z_t = a(L)\Delta^2 y_t$ is the only observed variable.

The Measurement and State equations corresponding to (4) are:

KOSSM

$$\text{Measurement : } Z_t = D_1 X_t + D_2 X_{t-1} + R \varepsilon_t$$

$$Z_t = \underbrace{\begin{bmatrix} \sigma_1 & 0 & \sigma_3 & -\sigma_1(2 + a_1) & \sigma_1(1 + 2a_1 - a_2) & \sigma_1(2a_2 - a_1) & 0 & 0 & 0 \end{bmatrix}}_{D_1} \underbrace{\begin{bmatrix} \varepsilon_{1t} \\ \varepsilon_{2t} \\ \varepsilon_{3t} \\ \varepsilon_{1t-1} \\ \varepsilon_{1t-2} \\ \varepsilon_{1t-3} \\ \varepsilon_{2t-1} \\ \varepsilon_{2t-2} \\ \varepsilon_{3t-1} \end{bmatrix}}_{X_t} \tag{6a}$$

$$+ \underbrace{\begin{bmatrix} 0 & \sigma_2 & -2\sigma_3 & 0 & 0 & -\sigma_1 a_2 & -\sigma_2 a_1 & -\sigma_2 a_2 & \sigma_3 \end{bmatrix}}_{D_2} \underbrace{\begin{bmatrix} \varepsilon_{1t-1} \\ \varepsilon_{2t-1} \\ \varepsilon_{3t-1} \\ \varepsilon_{1t-2} \\ \varepsilon_{1t-3} \\ \varepsilon_{1t-4} \\ \varepsilon_{2t-2} \\ \varepsilon_{2t-3} \\ \varepsilon_{3t-2} \end{bmatrix}}_{X_{t-1}} + \underbrace{\begin{bmatrix} 0 & 0 & 0 \end{bmatrix}}_R \underbrace{\begin{bmatrix} \varepsilon_{1t} \\ \varepsilon_{2t} \\ \varepsilon_{3t} \end{bmatrix}}_{\varepsilon_t} \tag{6b}$$

$$\text{State : } X_t = A X_{t-1} + C \varepsilon_t,$$

$$\begin{aligned}
\underbrace{\begin{bmatrix} \varepsilon_{1t} \\ \varepsilon_{2t} \\ \varepsilon_{3t} \\ \varepsilon_{1t-1} \\ \varepsilon_{1t-2} \\ \varepsilon_{1t-3} \\ \varepsilon_{2t-1} \\ \varepsilon_{2t-2} \\ \varepsilon_{3t-1} \end{bmatrix}}_{X_t} &= \underbrace{\begin{bmatrix} 0 & 0 & 0 & 0 & 0 & 0 & 0 & 0 & 0 \\ 0 & 0 & 0 & 0 & 0 & 0 & 0 & 0 & 0 \\ 0 & 0 & 0 & 0 & 0 & 0 & 0 & 0 & 0 \\ 1 & 0 & 0 & 0 & 0 & 0 & 0 & 0 & 0 \\ 0 & 0 & 0 & 1 & 0 & 0 & 0 & 0 & 0 \\ 0 & 0 & 0 & 0 & 1 & 0 & 0 & 0 & 0 \\ 0 & 1 & 0 & 0 & 0 & 0 & 0 & 0 & 0 \\ 0 & 0 & 0 & 0 & 0 & 0 & 1 & 0 & 0 \\ 0 & 0 & 1 & 0 & 0 & 0 & 0 & 0 & 0 \end{bmatrix}}_A \underbrace{\begin{bmatrix} \varepsilon_{1t-1} \\ \varepsilon_{2t-1} \\ \varepsilon_{3t-1} \\ \varepsilon_{1t-2} \\ \varepsilon_{1t-3} \\ \varepsilon_{2t-2} \\ \varepsilon_{2t-3} \\ \varepsilon_{3t-2} \end{bmatrix}}_{X_{t-1}} + \underbrace{\begin{bmatrix} 1 & 0 & 0 \\ 0 & 1 & 0 \\ 0 & 0 & 1 \\ 0 & 0 & 0 \\ 0 & 0 & 0 \\ 0 & 0 & 0 \\ 0 & 0 & 0 \\ 0 & 0 & 0 \end{bmatrix}}_C \underbrace{\begin{bmatrix} \varepsilon_{1t} \\ \varepsilon_{2t} \\ \varepsilon_{3t} \end{bmatrix}}_{\varepsilon_t}. \quad (6c)
\end{aligned}$$

3 Alternative formulation

Try to reduce the state vector X_t by using changes:

$$\Delta^2 y_t = \Delta^2 y_t^* + \Delta^2 \tilde{y}_t \quad (7)$$

$$\Delta^2 y_t^* = \sigma_2 \varepsilon_{2t-1} + \sigma_1 \Delta \varepsilon_{1t} \quad (8)$$

$$\Delta^2 \tilde{y}_t = a(L)^{-1} \sigma_3 \Delta^2 \varepsilon_{3t}, \quad (9)$$

so that

$$\begin{aligned}
\Delta^2 y_t &= \Delta^2 y_t^* + \Delta^2 \tilde{y}_t \\
&= \sigma_2 \varepsilon_{2t-1} + \sigma_1 \Delta \varepsilon_{1t} + a(L)^{-1} \sigma_3 \Delta^2 \varepsilon_{3t} \\
\Leftrightarrow \underbrace{a(L) \Delta^2 y_t}_{Z_t} &= \sigma_2 a(L) \varepsilon_{2t-1} + \sigma_1 a(L) \Delta \varepsilon_{1t} + \sigma_3 \Delta^2 \varepsilon_{3t} \\
Z_t &= \sigma_1 a(L) \Delta \varepsilon_{1t} + \sigma_2 a(L) \varepsilon_{2t-1} + \sigma_3 \Delta^2 \varepsilon_{3t} \\
&= \sigma_1 \Delta \varepsilon_{1t} - a_1 \sigma_1 \Delta \varepsilon_{1t-1} - a_2 \sigma_1 \Delta \varepsilon_{1t-2} \\
&\quad + \sigma_2 \varepsilon_{2t-1} - a_1 \sigma_2 \varepsilon_{2t-2} - a_2 \sigma_2 \varepsilon_{2t-3} \\
&\quad + \sigma_3 \Delta \varepsilon_{3t} - \sigma_3 \Delta \varepsilon_{3t-1}
\end{aligned}$$

This is correct now:

$$\begin{aligned}
&\begin{bmatrix} \sigma_1 & 0 & 0 & -a_1 \sigma_2 & -a_1 \sigma_1 & \sigma_3 \end{bmatrix} \begin{bmatrix} \varepsilon_{1t} \\ \varepsilon_{2t} \\ \varepsilon_{3t} \\ \varepsilon_{2t-2} \\ \Delta \varepsilon_{1t-1} \\ \Delta \varepsilon_{3t} \end{bmatrix} + \begin{bmatrix} -\sigma_1 & \sigma_2 & 0 & -a_2 \sigma_2 & -a_2 \sigma_1 & -\sigma_3 \end{bmatrix} \begin{bmatrix} \varepsilon_{1t-1} \\ \varepsilon_{2t-1} \\ \varepsilon_{3t-1} \\ \varepsilon_{2t-3} \\ \Delta \varepsilon_{1t-2} \\ \Delta \varepsilon_{3t-1} \end{bmatrix} = \sigma_2 \varepsilon_{2t-1} - \\
&\sigma_1 \varepsilon_{t-1} + \sigma_1 \varepsilon_t + \Delta \sigma_3 \varepsilon_{3t} - \Delta \sigma_3 \varepsilon_{3t-1} - \sigma_2 a_1 \varepsilon_{2t-2} - \sigma_2 a_2 \varepsilon_{2t-3} - \Delta \sigma_1 a_1 \varepsilon_{t-1} - \Delta \sigma_1 a_2 \varepsilon_{t-2}
\end{aligned}$$

Measurement : $Z_t = D_1 X_t + D_2 X_{t-1} + R \varepsilon_t$

$$Z_t = \underbrace{\begin{bmatrix} \sigma_1 & 0 & \sigma_3 & -\sigma_1(2+a_1) & \sigma_1(1+2a_1-a_2) & \sigma_1(2a_2-a_1) & 0 & 0 & 0 \end{bmatrix}}_{D_1} \underbrace{\begin{bmatrix} \varepsilon_{1t} \\ \varepsilon_{2t} \\ \varepsilon_{3t} \\ \varepsilon_{1t-1} \\ \varepsilon_{1t-2} \\ \varepsilon_{1t-3} \\ \varepsilon_{2t-1} \\ \varepsilon_{2t-2} \\ \varepsilon_{3t-1} \end{bmatrix}}_{X_t} \quad (10)$$

$$+ \underbrace{\begin{bmatrix} 0 & \sigma_2 & -2\sigma_3 & 0 & 0 & -\sigma_1 a_2 & -\sigma_2 a_1 & -\sigma_2 a_2 & \sigma_3 \end{bmatrix}}_{D_2} \underbrace{\begin{bmatrix} \varepsilon_{1t-1} \\ \varepsilon_{2t-1} \\ \varepsilon_{3t-1} \\ \varepsilon_{1t-2} \\ \varepsilon_{1t-3} \\ \varepsilon_{1t-4} \\ \varepsilon_{2t-2} \\ \varepsilon_{2t-3} \\ \varepsilon_{3t-2} \end{bmatrix}}_{X_{t-1}} + \underbrace{\begin{bmatrix} 0 & 0 & 0 \end{bmatrix}}_R \underbrace{\begin{bmatrix} \varepsilon_{1t} \\ \varepsilon_{2t} \\ \varepsilon_{3t} \end{bmatrix}}_{\varepsilon_t} \quad (11)$$