Deflationary financial shocks and inflationary uncertainty shocks an SVAR Investigation

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Abstract

What are the economic implications of financial and uncertainty shocks? We show that financial shocks cause a decline in output and goods prices, while uncertainty shocks cause a decline in output and an increase in goods prices. In response to un-certainty shocks, firms increase their markups, in line with the theory of self-insurance against being stuck with too low a price. This explains why goods prices may increase at the onset of a recession and are not accompanied by pronounced deflationary pressures. The two shocks are identified jointly with an approach that is less restrictive than Antolín-Díaz and Rubio-Ramírez’s method.

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