



Finance and Economics Discussion
Series: Two Practical Algorithms for
Solving Rational Expectations Models

United States Federal Reserve
Board, Flint Brayton



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Finance and Economics Discussion Series: Two Practical Algorithms for Solving Rational Expectations Models

By Flint Brayton

Bibliogov, United States, 2013. Paperback. Book Condition: New. 246 x 189 mm. Language: English . Brand New Book ***** Print on Demand *****.This paper describes the E-Newton and E-QNewton algorithms for solving rational expectations (RE) models. Both algorithms treat a model's RE terms as exogenous variables whose values are iteratively updated until they (hopefully) satisfy the RE requirement. In E-Newton, the updates are based on Newton's method; E-QNewton uses an efficient form of Broyden's quasi-Newton method. The paper shows that the algorithms are reliable, fast enough for practical use on a mid-range PC, and simple enough that their implementation does not require highly specialized software. The evaluation of the algorithms is based on experiments with three well-known macro models--the Smets-Wouters (SW) model, EDO, and FRB/US--using code written in EViews, a general-purpose, easy-to-use software package. The models are either linear (SW and EDO) or mildly nonlinear (FRB/US). A test of the robustness of the algorithms in the presence of substantial nonlinearity is based on modified versions of each model that include a smoothed form of the constraint that the short-term rate of interest cannot fall below zero. In two single-simulation experiments with the standard and modified versions of...



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