

I'm still here - trying to read up on 2 Kings 27 Feb 2020

- 1) Solutions to systems of diff eqs that are 1) non-autonomous  
2) have time-varying coeffs i.e.

$$X_t = A_{t-1} X_{t-1} + M_t b_t$$

- 2) Solutions to nonlinear diff eqs.

Reading Elaydi - Undergrd ... pdf

$k^{\text{th}}$  order nonhomogen diff eq:

$$y_{n+k} + p_{1,n} y_{n+k-1} + \dots + p_{k,n} y_n = g_n$$

↑  
forcing term

Erm... so far not a lot of useful stuff.

But on p. 115 (mac), at least Elaydi says that in general, nonlinear diff eqs cannot be solved explicitly. Some can, by transforming them to linear ones.

Type I: Riccati-style eq

$$x_{n+1} \cdot x_n + p_n x_{n+1} + q_n x_n = 0 \quad (2.6.1)$$

$$x_{n+1} \cdot x_n + p_n x_{n+1} + q_n x_n = 0$$

Introduce  $z_n = \frac{1}{x_n}$

$$\frac{1}{z_{n+1}} \cdot \frac{1}{z_n} + p_n \frac{1}{z_{n+1}} + q_n \frac{1}{z_n} = 0$$

$$\Rightarrow 1 + p_n z_n + q_n z_{n+1} = 0 \quad (2.6.2)$$

Holy! It works!

The nonhomogen Riccati:

$$y_{n+1} \cdot y_n + p_n y_{n+1} + q_n y_n = g_n \quad (2.6.3)$$

$$\text{Let } y_n = \frac{z_{n+1}}{z_n} - p_n$$

$$\left( \frac{z_{n+2}}{z_{n+1}} - p_{n+1} \right) \left( \frac{z_{n+1}}{z_n} - p_n \right) + p_n \left( \frac{z_{n+2}}{z_{n+1}} - p_{n+1} \right) + q_n \left( \frac{z_{n+1}}{z_n} - p_n \right) \\ = g_n$$

$$\cancel{\frac{z_{n+2}}{z_{n+1}} \frac{z_{n+1}}{z_n} - p_n \cancel{\frac{z_{n+2}}{z_{n+1}} - p_{n+1}}} + p_n \cancel{\frac{z_{n+1}}{z_n} + p_n \cancel{\frac{z_{n+2}}{z_{n+1}} - p_{n+1}}} \\ + q_n \frac{z_{n+1}}{z_n} - q_n p_n = g_n$$

$$\Rightarrow z_{n+2} - p_{n+1} z_{n+1} + q_n z_{n+1} - q_n p_n z_n - g_n z_n = 0$$

$$z_{n+2} + (q_n - p_{n+1}) z_{n+1} - (g_n + q_n p_n) z_n = 0 \quad \text{Yeah.}$$

The logistic eq. (Verhulst-Pearl) or logistic map, is an example of this

$$x_{t+1} = x_t(a - bx_t)$$

### Type II general Riccati types

$$x_{n+1} = \frac{a_n x_n + b_n}{c_n x_n + d_n} \quad (2.6.6)$$

To solve this, let  $c_n x_n + d_n = \frac{g_{n+1}}{g_n}$  (2.6.7)  
 (won't do)

and then group  $a_n, b_n, c_n$  and  $d_n$  in composite coeffs.

### Type III Homogen. diff eq of type

$$f\left(\frac{x_{n+1}}{x_n}, n\right) = 0$$

Use the transformation  $z_n = \frac{x_{n+1}}{x_n}$  to solve.

$$\text{Type IV} \quad y_{n+k}^{r_1} \cdot y_{n+k-1}^{r_2} \cdots y_n^{r_{k+1}} = g_n \quad (2.6.13)$$

Let  $z_n = \ln(y_n)$  to solve.

## Nonautonomous matrix system Elaydi-Undergal

p. 143 Mac

$$x(n+1) = A(n) x(n) \quad (3.2.1)$$

$k \times k$

$$x(n+1) = A(n) x(n) + g(n) \quad (3.2.2)$$

$k \times k$

Sol is  $\prod_{i=h_0}^{n-1} A(i) \cdot x_0 \quad (3.2.3)$

In fact  $\Phi(n) = \prod_{i=h_0}^{n-1} A(i)$  is known as the fundamental matrix

and satisfies  $\Phi(n+1) = A(n) \Phi(n) \quad (3.2.4)$

where if  $A(n) = A \ \forall n$ ,  $\Phi(n) = A^n$ .

Thm 3.15. Any sol of (3.2.2) can be written

$$y_n = \Phi_n \cdot c + y_p(n) \quad (3.2.10)$$

Lemma 3.16

$$y_p(n) = \sum_{r=h_0}^{n-1} \Phi(n, r+1) g(r)$$

Rephrase: Thm 3.17 (Variation of constants Formula)

The unique sol. to the initial value problem

p.147 Mac

$$y(n+1) = A(n) y(n) + g(n) \quad y(n_0) = y_0 \quad (3.2.11)$$

is

$$y(n, n_0, y_0) = \Phi(n, n_0) y_0 + \sum_{r=n_0}^{n-1} \Phi(n, r+1) g(r) \quad (3.2.12)$$

Doesn't aesthetically look like what Tirolli has, but  
is actually!

or, more explicitly,

$$y(n, n_0, y_0) = \left( \prod_{i=n_0}^{n-1} A(i) \right) y_0 + \sum_{r=n_0}^{n-1} \left( \prod_{i=r+1}^{n-1} A(i) \right) g(r) \quad (3.2.13)$$

Now I'm only confused b/c what is then the matrix  $A$ ?

Later, he says , matrix of eigenvectors , matrix of eigenvalues

$$\Phi(n) = A^n P = P \Lambda \quad (3.3.3)$$

(I think this is the non-time-varying  $A$ -case.)

so

$$\Phi(n) = [\lambda_1^n \xi_1, \lambda_2^n \xi_2, \dots, \lambda_k^n \xi_k] \quad (3.3.5)$$

↑ eigenvector

So the general sol to (3.2.1) ( $= 3, 3.2$ ) is

$$x(n) = c_1 \lambda_1^n \xi_1 + c_2 \lambda_2^n \xi_2 + \dots + c_k \lambda_k^n \xi_k$$

Cont. w Ex. 3.21

Interventions: I borrowed

28 Feb 2020

Goldberg 1958 and Baumol 1975 (3rd ed.)

↳ This one doesn't look too useful b/c it doesn't have time-varying coeffs. But some useful notes from it.

$$\text{For } Y(t) = M Y(t-1) + i$$

Goldberg p. 237

if

- elements of  $M$  are  $> 0$

- sum of elements in each column is less than 1

then eigs of  $M$  are less than 1 in abs. value.

Baumol isn't great either "

Sturm criterion on the roots of  $f(x)$

Baumol, p. 235

for a function  $f(x)$  whose roots ( $eigs$ ) we're trying to

find, derive the Sturm functions  $f_1(x), f_2(x), \dots, f_k(x)$ . Each Sturm function is of order previous - 1.

Then, define  $V(x) = \# \text{ changes in sign between } f(x), f_1(x), f_2(x) \dots f_k(x)$ .

(Here  $k$  is the order of  $f(x)$ )

Then: Sturm's theorem: If  $f(x)$  is a polynomial w/  
no multiple roots, and  $a < b \in \mathbb{R}^2$ , then the #  
of real roots of  $f(x)$  which lie between  $a$  &  $b$  is  
equal to  $V(a) - V(b)$ .

How to obtain the Sturm functions?

$$f_1(x) = \frac{d}{dx} f(x)$$

$$f_2(x) = (\text{remainder of long division of } f_1(x) \text{ into } f(x))(-1)$$

$f_3(x)$  & onwards is analogous to  $f_2(x)$ .

I just don't remember how to do long division :S

Another thing Baumol talks about is:

nonlinear diff eqs

- initial conditions don't matter as much as for linear ones p. 256.
- You can rationalize cycles (vs. in a linear world, cycles will either explode or disappear unless the largest complex eig. is exactly unity)  
→ independent of initial conditions
- seems to only treat its dynamics as a phase diagram
- so-called "limit cycles" := cycles of constant amplitude can be produced by a "closed phase line" i.e. one that is a circle, an elliptical, heart shaped, etc ...

Ok so now continue w/ Ergodic - Undergrad

I'm skipping the example. Instead, I note that the Jordan form,  $\tilde{f} = \tilde{P}^{-1}A\tilde{P}$ , is used when  $A$  is not

diagonizable, i.e. it has repeated roots.

$J = \text{diag}(\lambda_1, \dots, \lambda_r)$  where  $\lambda_i$  is called a Jordan block.

(Aka Jordan Canonical form, p. 159 Mac.)

The number of Jordan blocks corresponding to one eigenvalue is called the geometric multiplicity of  $\lambda$ , which also equals the number of lin. indep. eigenvectors corresponding to  $\lambda$ .

$$J_i = \begin{bmatrix} \lambda & 1 & 0 & \dots & 0 \\ 0 & \lambda & 1 & \dots & 0 \\ \vdots & 0 & \ddots & \ddots & 1 \\ 0 & \dots & 0 & \lambda & \end{bmatrix}$$

The algebraic multiplicity of  $\lambda$  is the number of times it is repeated.

Notes on cigs of Block-diagonal matrices  $C = \begin{bmatrix} A & 0 \\ 0 & B \end{bmatrix}$

p. 166 Mac.

I've stopped my reading of Elaydi - Undergrad again.  
 The reason is that there are two separate issues.

- 1) non-autonomous higher-order diff eqs w/ time-varying coeffs.

- 2) non-linear systems.

I want to do this step by step. B/c issue 1) also has a deeper issue: for a 2nd order eq w/ constant coeffs but non-autonomous, how do I know what to do for the "nodes"?

$$\text{E.g. } y_+ = \begin{pmatrix} 1 & 1 \\ 0 & 1 \end{pmatrix} y_{+-1} + b_+$$

Supp.  $P^{-1}AP = \Lambda$  and  $\Lambda = \begin{bmatrix} \lambda_1 & 0 \\ 0 & \lambda_2 \end{bmatrix}$  where  $|\lambda| < 1$   
 and  $|\lambda_2| > 1$  and  $(\lambda_1, \lambda_2) \in \mathbb{R}^2$ .

Or, as in Woodford's (2.6), underlying this could be a 2nd order diff eq

$$\beta y_{++1} - \alpha y_+ + y_{+-1} = kx^* + u_+ \quad (2.6)$$

where  $\alpha = (1 + \beta + \frac{k^2}{\lambda})$

p. 488

We know that  $y_+^c = c_1 \lambda_1^t P_1 + c_2 \lambda_2^t P_2$

$$\varphi_t^P = \sum_{r=0}^{t-1} [\lambda_1^r \xi_1, \lambda_2^r \xi_2] u_r$$

$$= \sum_{r=0}^{t-1} \lambda_1^r \xi_1 u_r + \sum_{r=0}^{t-1} \lambda_2^r \xi_2 u_r \quad \text{since } u \text{ scalar}$$

Since  $|\lambda_2| > 1$  it's clear that this won't do.

Try to iterate (2.6) fwd:

$$\beta \varphi_{t+1} - \alpha \varphi_t + \varphi_{t-1} = kx^* + u_t \quad (2.6)$$

$$\begin{aligned} \varphi_{t-1} &= -\beta \varphi_{t+1} + \alpha \varphi_t + kx^* + u_t \\ &= -\beta [-\beta \varphi_{t+2} + \alpha \varphi_{t+1} + kx^* + u_{t+1}] \\ &\quad + \alpha [-\beta \varphi_{t+2} + \alpha \varphi_{t+1} + kx^* + u_{t+1}] \\ &\quad + kx^* + u_t \end{aligned}$$

Ignore the  $kx^*$  terms and the vanishing  $\varphi_{t+k}$ .

$$= u_t - \beta u_{t+2} + \alpha u_{t+1}$$

Sorry I can't think of what the pattern is. All I'm seeing is that  $\beta$  looks like it was associated w/ the smaller eigenvalue and  $\alpha$  w/ the bigger one. So maybe try

$$\text{like } \varphi_t^P = \sum_{r=0}^{t-1} \lambda_1^r \xi_1 u_r + \sum_{r=t}^{\infty} \tilde{\lambda}_2^{(r-t)} \xi_2 u_r$$

So maybe Woodford understood that  $\xi_1$  blocks  $u_t$  and  $\lambda_2^+$  from materializing?

Recall that eigenvectors for a  $2 \times 2$  are given by

$$\xi_i = \begin{bmatrix} \lambda_i - a_{22} \\ a_{21} \\ 1 \end{bmatrix}$$

But even if  $\frac{\lambda_1 - a_{22}}{a_{21}}$  would be zero,

$$\lambda_1^t \begin{bmatrix} 0 \\ 1 \end{bmatrix} u_t = \begin{bmatrix} 0 \\ \lambda_1^+ u_t \end{bmatrix} \quad \text{set } c_2 = 0$$

$$\begin{bmatrix} y_t \\ y_{L_t} \end{bmatrix} = P_{2t} \dots \quad \text{I don't know b/c I don't know how to translate the sol of a } 2 \times 2 \text{ system back to the 2nd order one ... ?}$$

Note: another way of analyzing diff. eqs or ODE's is by transforming them to the frequency domain.

- ODE's: Laplace transform

- diff eqs: Z-transform (DeMoivre, 1730s)

→ "generating functions" in probability theory)

Z-transform of a sequence  $x(n)$  is defined as

$$\tilde{x}(n) = Z(x(n)) \equiv \sum_{j=0}^{\infty} x(j) z^{-j} \quad \text{where } z \in \mathbb{C} \quad (6.11)$$

For what  $z$  does this series converge?

$$\text{If } \lim_{j \rightarrow \infty} \left| \frac{x(j+1)}{x(j)} \right| = R \quad (\text{ratio test})$$

$R$  = "Radius of convergence". Then if  $|z| > R$ ,  $Z(x(n))$  converges, if  $|z| < R$  it diverges.

A very interesting side note

A convolution of two sequences  $x(n)$  &  $y(n)$   
is defined by

$$x(n) * y(n) = \sum_{j=0}^{\infty} x(n-j)y(j) = \sum_{j=0}^{\infty} x(n) y(n-j)$$

↑  
symbol

commutative property  
of convolution

The Z-transform of this convolution is

$$Z(x(n) * y(n)) = \tilde{x}(n) \tilde{y}(n) \quad (6.1.12)$$

Is this helpful for me?

↳ on a similar note: check out Thm 6.27. p. 322 Mac.

## Oscillation theory

### Three-term difference equations

p. 328 Mac

$$x(n+1) - x(n) + p(n)x(n-k) = 0 \quad (7.1.1)$$

This is a 3-term diff. eq. of order  $k+1$ .

$p(n)$  is a sequence.

A solution  $x(n)$  is oscillatory if  $x(n) - x^*$  fluctuates around 0 (where  $x^* = 0$  here, st. st.)

### Self-adjoint second order equations

p. 335 Mac

$$p(n)x(n+1) + p(n-1)x(n-1) = b(n)x(n) \quad (7.2.2)$$

$$\text{where } b(n) = p(n-1) + p(n) - q(n) \quad (7.2.3)$$

Eraydi is able to find  $p(n)$  and  $q(n)$  here.

## Control Theory

p. 442 Mac

controlled system is the nonhomogeneous system:

$$x(n+1) = Ax(n) + u(n)$$

Or

$$x(n+1) = Ax(n) + Bu(n) \quad (10.1.3)$$

Elaydi first investigates the question of whether this system is controllable: if it is, then a  $u(n)$  sequence exists and a finite  $N$  such that  $x(N) = x_f \leftarrow$  desired value. In this case, we say  $(A, B)$  is a controllable pair.

The system is controllable if a controllability matrix  $W$  has  $\text{rank}(W) = k$ .

Observability: a state-space system is observable if from measuring the output only, you can infer the state.

Durability: a system is controllable if its counterpart is observable. (sic!)

Now I've returned to the "variations of constants" formula Elaydi describes on p. 147 Mac and which I've written earlier.

Maybe there he means that the system

$$y(n+1) = A(n)y(n) + g(n) \quad y(n_0) = y_0 \quad (3.2.11)$$

is the already decoupled system, so that the sol,

$$y(n, n_0, y_0) = \left( \prod_{i=n_0}^{n-1} A(i) \right) y_0 + \sum_{r=n_0}^{n-1} \left( \prod_{i=r+1}^{n-1} A(i) \right) g(r) \quad (3.2.13)$$

is actually the sol of the transformed system

so you still need to multiply by the eigenvectors P.

↳ maybe Woodford is focusing on the explosive eig for the particular sol b/c the stable one won't matter for the dynamics as  $t \rightarrow \infty$ ?

I know I've already done this but let's make sure that (3.12) is really the complementary sol; i.e.

that  $\varphi_+ =$

$$\begin{aligned}-\frac{\lambda}{K} x^* (1 - \mu_1^{t+1}) &= \mu_1 \varphi_{+-1} - (1 - \mu_1) \frac{\lambda}{K} x^* \\&= \mu_1 \left( -\frac{\lambda}{K} x^* (1 - \mu_1^t) \right) - (1 - \mu_1) \frac{\lambda}{K} x^* \\&= -\frac{\lambda}{K} x^* \left[ \mu_1 (1 - \mu_1^t) + 1 - \mu_1 \right] \\&= -\frac{\lambda}{K} x^* \left[ \mu_1 - \mu_1^{t+1} + 1 - \mu_1 \right] \\&= -\frac{\lambda}{K} x^* [1 - \mu_1^{t+1}] \text{ ok!}\end{aligned}$$

What's the eigenvector of  $A$ ?

$$\beta E \varphi_{++1} - \alpha \varphi_+ + \varphi_{+-1} = 0$$

$$E \varphi_{++1} - \frac{\alpha}{\beta} \varphi_+ + \frac{1}{\beta} \varphi_{+-1} = 0$$

Let  $x_+ \equiv \varphi_{+-1}$  so that  $x_{++1} \equiv \varphi_+$

$$\varphi_{++1} - \frac{\alpha}{\beta} \varphi_+ + \frac{1}{\beta} x_+ = 0$$

$$x_{++1} - \varphi_+ = 0$$

$$\begin{bmatrix} 1 & 0 \\ 0 & 1 \end{bmatrix} \begin{bmatrix} \varphi_{++1} \\ x_{++1} \end{bmatrix} + \begin{bmatrix} -\frac{\alpha}{\beta} & \frac{1}{\beta} \\ -1 & 0 \end{bmatrix} \begin{bmatrix} \varphi_+ \\ x_+ \end{bmatrix} = \begin{bmatrix} 0 \\ 0 \end{bmatrix}$$

or

$$\begin{bmatrix} Y_{t+1} \\ X_{t+1} \end{bmatrix} = \begin{bmatrix} \frac{\alpha}{\beta} - \beta \\ 1 \quad 0 \end{bmatrix} \begin{bmatrix} Y_t \\ X_t \end{bmatrix} + \begin{bmatrix} 0 \\ 0 \end{bmatrix}$$

Eigenvectors are  $\xi_1 = \frac{\lambda_1 - \alpha_{22}}{\alpha_{21}} = \frac{\lambda_1 - 0}{1}$

so eigenvectors here are just  $\xi_1 = \begin{bmatrix} 2 \\ 1 \end{bmatrix}$  and  $\xi_2 = \begin{bmatrix} 1 \\ 1 \end{bmatrix}$

which might explain b/w why Woodford gets

$$Y_t = -\frac{\gamma}{\beta} X^* (1 - \mu_1^{(t+1)})$$

ok but for the life of me I can't figure out the  $\frac{1}{\beta}$ .

### "Difference Equations & Inequalities" (pdf)

An initial value problem is a special case of the boundary value problem.

## difference-eqs-jenson.pdf

For the inhomogenous eq w/ variable coefficients

$$x(n+2) + b(n)x(n+1) + c(n)x(n) = g(n) \quad (6.30)$$

The variation of parameters method says that for  $x_1$  &  $x_2$  two linearly independent sols to the homogeneous version of (6.30), the particular solution to (6.30) is

$$x_p(n) = u_1(n)x_1(n) + u_2(n)x_2(n)$$

where  $u_1(n) = - \sum_{k=0}^{n-1} \frac{g(k)x_2(k+1)}{w(k+1)}$

$$u_2(n) = \sum_{k=0}^{n-1} \frac{g(k)x_1(k+1)}{w(k+1)}$$

And I think  $x_1$  &  $x_2$  are the two eigenvalues  
and  $w(k+1)$  is the casoratian. WTF is that

## Def. Casoratian

$$W(n) = \begin{vmatrix} x_1(n) & x_2(n) & \dots & x_N(n) \\ x_1(n+1) & x_2(n+1) & \dots & x_N(n+1) \\ \vdots & \vdots & & \vdots \\ x_1(n+N-1) & x_2(n+N-1) & \dots & x_N(n+N-1) \end{vmatrix}$$

The <sup>NxN</sup> determinant of a series of vectors (sequences).

i.e. if for vectors  $x_1, \dots, x_n$  the <sup>0<sup>th</sup></sup> element  $n_0$  is s.t.  
 $\hookrightarrow$  (1<sup>st</sup>)

$$W(n_0) \neq 0$$

Then the vectors are linearly independent.

I'm not sure what it's doing. Maybe that's where Woodford gets the  $\frac{1}{\beta}$  from?

I'm confused about this goddamn

1 March 2020

Casoratian. In difference ... person.pdf, we also have this interesting statement: for the 2<sup>nd</sup> order diff eq, if we have two different real roots,  $\lambda_1$  &  $\lambda_2$ ,

$$\text{then } W(n_0) = W(0) = \begin{vmatrix} \lambda_1^0 & \lambda_2^0 \\ \lambda_1^1 & \lambda_2^1 \end{vmatrix}$$

$$= \lambda_1^0 \lambda_2^1 - \lambda_1^1 \lambda_2^0 = \lambda_2 - \lambda_1 \neq 0$$

(so these seem to be to the powers 1 and 0  
- that wasn't obvious from the def. at all!)

Ah I get it! The sol  $x_i(n) = \lambda_i^n$  so the sequence is  $\lambda_1^0, \lambda_1^1, \lambda_2^2, \dots$  etc... Ok!)

So for Woodford  $\beta E y_{t+1} - a y_t + y_{t-1} = 0$   
 $\rightarrow$  so the characteristic is  $\beta \mu^2 - a \mu + 1 = 0$

$$\mu_{1,2} = \frac{a \pm \sqrt{a^2 - 4\beta}}{2} \quad \text{so} \quad \mu_2 - \mu_1 = \frac{a + \sqrt{a^2 - 4\beta} - (a - \sqrt{\cdot})}{2}$$

$$= \sqrt{a^2 - 4\beta} \quad \text{hm. Well that's not zero at least :D}$$

But the thing is that if  $W(0) \neq 0$ , then  $\forall n > 0$   
 $W(n) \neq 0$ .

By the way, it seems like for systems of diff eqs,

$$Y_{t+1} = A_t Y_t + \text{stuff},$$

$A^t Y_0$  IS a sol, even if  $A$  isn't diagonal. But,

apparently, for non-diagonal  $A$ ,  $A^t$  is difficult to compute. And that's why we use

$$A^t = P \Lambda^t P^{-1} \quad \text{b/c } \Lambda^t \text{ is easy to get.}$$

I've tried to google "stochastic diff eq" b/c

the nonhomogeneous part should

- not be a constant

- not be a simple function of time, like  $c t$

- ideally it should be a series, like  $b_t$

→ so I've turned to time series b/c AR-processes usually have this feature.

The problem there is that for a scalar AR-process,

you just check whether it's invertible and then

you back out the filters by the Wold Decomp, which is

really just the particular solution to the equation...  
 But a scalar won't do b/c you just take the first  
 or bwd-sol depending on whether the AR-coeff  $\geq 1$ .  
 $\Rightarrow$  So invertibility of VAR!

$\hookrightarrow$  Hamilton! Econ Let. 7 p. 7-8.

## HAMILTON

Note that Hamilton also has a treatment of  
 difference equations. E.g. on p. 22 Mac,

$$\xi_t = F \xi_{t-1} + v_t \quad [1.2.5]$$

=

$\downarrow$  F is called the companion matrix

$$\begin{bmatrix} y_t \\ y_{t-1} \\ y_{t-2} \\ \vdots \\ y_{t-p+1} \end{bmatrix} = \begin{bmatrix} \phi_1 & \phi_2 & \dots & \phi_{p-1} & \phi_p \\ 1 & 0 & \cdots & 0 & 0 \\ 0 & 1 & & \vdots & \vdots \\ \vdots & 0 & \ddots & \ddots & \vdots \\ 0 & 0 & \cdots & 0 & 1 \end{bmatrix} \begin{bmatrix} y_{t-1} \\ y_{t-2} \\ y_{t-3} \\ \vdots \\ y_{t-p} \end{bmatrix} + \begin{bmatrix} w_t \\ 0 \\ 0 \\ \vdots \\ 0 \end{bmatrix}$$

$\rightarrow$  and Hamilton shows exactly this:

$$F^j = T \Lambda^j T^{-1} \quad [1.2.19]$$

$\uparrow$   
eigenvectors

An interesting result in Hamilton is that you can thus for the  $p$ -order system [1.2.5] use the eigenvalues & eigenvectors to write down a closed-form expression for the impulse response

$$\frac{\partial y_{t+k}}{\partial w_t} = F(1,1) = c_1 \lambda_1^k + c_2 \lambda_2^k + \dots c_p \lambda_p^k$$

w/  $c_1 + c_2 + \dots + c_p = 1$  and given by a particular transformation of eigenvectors to

[1.2.25].

Ok finally a hint: Hamilton is talking about IRFs, which he refers to as dynamic multipliers. He says on p 28 (Mac) that if all eigs are real but 1 is  $> 1$ , then eventually that one dominates the dynamics. In that case the dynamic multiplier is

eventually  $\lim_{j \rightarrow \infty} \frac{\partial y_{t+j}}{\partial w_t} = c_1 \lambda_1^j$  so Woodford seems to consider that in the limit the bigger eig. dominates the system.

Oh lookie! Hamilton, p. 31 (Mac). For the 2<sup>nd</sup>

order diff eq w/ real eigs  $\lambda_1 > \lambda_2$ ,

$$\lambda_1 > 1 \text{ whenever } \frac{\phi_1 + \sqrt{\phi_1^2 + 4\phi_2}}{2} > 1$$

$$\text{or } \sqrt{\phi_1^2 + 4\phi_2} > 2 - \phi_1$$

Not a big surprise tho if you think about it.

For woodprod:

$$\mu_2 > \mu_1$$

$$\beta y_{t+1} - \alpha y_t + y_{t-1} = 0$$

$$\mu^2 - \frac{\alpha}{\beta} \mu + \frac{1}{\beta} = 0$$

$$\alpha = \left(1 + \beta + \frac{k^2}{\lambda}\right)$$

or

$$y_{t+1} = \underbrace{\frac{\alpha}{\beta} y_t}_{\phi_1} - \underbrace{\frac{1}{\beta} y_{t-1}}_{\phi_2}$$

$$\sqrt{\frac{\alpha^2}{\beta^2} - 4 \frac{1}{\beta}} > 2 - \frac{\alpha}{\beta} ?$$

$$\text{Is } \frac{\alpha}{\beta} > 2 ? \quad \frac{\alpha}{\beta} = \frac{1 + \beta + \frac{k^2}{\lambda}}{\beta}$$

Even if  $\frac{k^2}{\lambda} = \min = 0$ , then  $\frac{\alpha}{\beta} > 2$  b/c  $\beta < 1$

OK!

Both  $|\phi_1| > 1$  and  $|\phi_2| > 1$

But so Newton reasons that if  $\lambda_1, \lambda_2 \in \mathbb{R}^2$

$$\sqrt{\phi_1^2 + 4\phi_2} > 2 - \phi_1$$

will hold for any  $\phi_1 > 2$ . If  $\phi_1 < 2$ , then if  $(\phi_1, \phi_2)$  lies northeast of the line  $\phi_2 = 1 - \phi_1$  we're still good

there's also a discussion of the "effect on the present value of  $y$  of a transitory increase in  $w$ ".

First consider the vector system and ask the effect on the present value of  $\xi$  of a transitory increase in  $v$ :

$v:$        $\downarrow \text{Proj } \xi$

$$\frac{\partial \sum_{j=0}^{\infty} \beta^j \xi_{t+j}}{\partial v_t} = \sum_{j=0}^{\infty} \beta^j F^j = (I_P - \beta F)^{-1} [1.246]$$

(a discounted sum of IRFs, like a discounted cumsum)  $\rightarrow$

For this not to explode we need all  $|\lambda_i| < \beta^{-1}$ .

The effect on  $y_t - PV$  is just the  $(1, 1)$ -element of  $[1.2.46]$ . Is Woodford using this?

→ exactly! As Hamilton says, a cumsum is a special case of this w/o discounting ( $\beta = 1$ )

Prop. 1.3. (p. 34 Mac)

If all eigs of the  $p \times p$  matrix  $F$  of [1.2.3] are less than  $\beta^{-1}$  in modulus, the matrix  $(I_p - \beta F)^{-1}$  exists and the effect of  $w$  on the present value of  $y$  is given by its first element, which is

$$\frac{1}{1 - \phi_1 \beta - \phi_2 \beta^2 - \dots - \phi_p \beta^p}$$

So if  $F$  is  $2 \times 2$  (as for Woodford), and eigs were all  $< 1$ , this would be

$$\frac{1}{1 - \phi_1 \beta - \phi_2 \beta^2}$$

Hamilton says that this can also be interpreted as the long-run effect on  $y$  of a permanent change in  $w$ . Can it be that for an eig  $> 1$ , you'd write sthg like

$$1 / (1 - \phi_1^{-1} \beta - \phi_2^{-1} \beta^2) ?$$

Cont tomorrow w/ lag operators in Hamilton.

## Lag operators

2 March 2020

A time series operator transforms one time series into a new time series. Takes as an input  $\{x_t\}_{t=-\infty}^{\infty}$  and as an output  $\{y_t\}_{t=-\infty}^{\infty}$

Transform a series  $\{x_t\}$  into  $\{y_t\} = \{x_{t-1}\}$  as

$$Lx_t = x_{t-1}$$

Applying it twice is

$$L^2 x_t = x_{t-2}$$

Note that  $L$  is commutative, associative & distributive.

From this follows that

$$\begin{aligned} y_t &= (a + bL)Lx_t \\ &= aLx_t + bL^2x_t \\ &= (aL + bL^2)x_t \end{aligned}$$

That's where the factoring of polynomials comes in.  
Such an expression is called a lag polynomial.

Another example for a polynomial in the lag operator

$$\begin{aligned} \text{is } (1 - \lambda_1 L)(1 - \lambda_2 L)x_+ &= (1 - \lambda_1 L - \lambda_2 L + \lambda_1 \lambda_2 L^2)x_+ \\ &= (1 - (\lambda_1 + \lambda_2)L + \lambda_1 \lambda_2 L^2)x_+ \\ &= x_+ - (\lambda_1 + \lambda_2)x_{+-1} + \lambda_1 \lambda_2 x_{+-2} \end{aligned}$$

thus the first-order difference eq

$$y_+ = \phi y_{+-1} + w_+$$

can be written as

$$y_+ = \phi L y_+ + w_+$$

$$(1 - \phi L)y_+ = w_+$$

We also saw previously that we can recursively sum backward to write the series as

$$\begin{aligned} y_+ &= \phi^{t+1} y_{-1} + w_+ + \phi w_{-1} + \phi^2 w_{-2} + \dots + \phi^t w_t \\ &= \underbrace{\phi^{t+1} + \dots}_{\phi L^{t+1}} y_+ + (1 + \phi L + \phi L^2 + \dots + \phi^t L^t) w_t \end{aligned}$$

$$\underbrace{(1 - \phi^{t+1} L^{t+1})}_{(1 - \phi L - \phi L^2 - \dots - \phi^t L^t)} y_+ = (1 + \phi L + \phi L^2 + \dots + \phi^t L^t) w_t$$

As  $t \rightarrow \infty$ , this term vanishes. That's nothing new.

But what Hamilton shows is the following:

You can derive the Wold decompos by taking

$$(1 - \phi L) y_t = w_t$$

and simply multiplying both sides by  $(1 + \phi L + \phi^2 L^2 + \dots + \phi^t L^t)$

During the calculation, you discover that

$$(1 + \phi L + \phi^2 L^2 + \dots + \phi^t L^t) (1 - \phi L) y_t = (1 - \phi^{t+1} L^{t+1}) y_t$$

(You can verify this by multiplying out the lag polynomial on the LHS.) Since  $\phi^{t+1} L^{t+1} \rightarrow 0$  as  $t \rightarrow \infty$

$$(1 + \phi L + \phi^2 L^2 + \dots + \phi^t L^t) (1 - \phi L) \approx 1 \quad \text{when } t \rightarrow \infty$$

$$\Leftrightarrow (1 + \phi L + \phi^2 L^2 + \dots + \phi^t L^t) \approx \frac{1}{1 - \phi L} \quad \text{when } t \rightarrow \infty \text{ (sic!)}$$

(when  $|\phi| < 1$ )

Formally, when  $|\phi| < 1$  and the sequence  $\{y_t\}$  is bounded,

$$\lim_{j \rightarrow \infty} (1 + \phi L + \phi^2 L^2 + \dots + \phi^j L^j) = (1 - \phi L)^{-1}$$

$$\begin{aligned} \text{which is why } y_t &= (1 - \phi L)^{-1} w_t \\ &= w_t + \phi w_{t-1} + \phi^2 w_{t-2} + \dots \end{aligned}$$

## Second-order difference equations

$$y_t = \phi_1 y_{t-1} + \phi_2 y_{t-2} + w_t$$

[2.3.1]

$$= (\phi_1 L + \phi_2 L^2) y_t + w_t$$

$$(1 - \phi_1 L - \phi_2 L^2) y_t = w_t$$

$$\underbrace{(1 - \phi_1 L - \phi_2 L^2)}_{\text{factor this as}} \cdot (1 - \lambda_1 L)(1 - \lambda_2 L) = 1 - \lambda_1 L - \lambda_2 L + \lambda_1 \lambda_2 L^2 \\ = 1 - (\lambda_1 + \lambda_2)L + \lambda_1 \lambda_2 L^2$$

$\Rightarrow$  it is clear that  $(\lambda_1, \lambda_2)$  need to satisfy:

$$\lambda_1 + \lambda_2 = \phi_1$$

$$\lambda_1 \lambda_2 = -\phi_2$$

Scalar  
↓

You can also do this the following way: replace  $L$  by  $z$ :

$$1 - \phi_1 z - \phi_2 z^2 = (1 - \lambda_1 z)(1 - \lambda_2 z)$$

What values of  $z$  make this hold? If  $z = \lambda_1^{-1}$  or  $\lambda_2^{-1}$

Prop. 2.1.

Factoring the polynomial  $(1 - \phi_1 L - \phi_2 L^2)$  as

$1 - \phi_1 L - \phi_2 L^2 = (1 - \lambda_1 L)(1 - \lambda_2 L)$  is the same thing

as finding the eigenvalues of  $F$ , in fact, you obtain the same eigs  $\lambda_1, \lambda_2$ .

A possible confusion in language:

We just stated the equivalence between solving the characteristic equation

$$\lambda^2 - \phi_1\lambda - \phi_2 = 0 \quad [2.3.19]$$

for its roots, the eigenvalues  $\lambda_{1,2}$  and we said they should lie inside the unit circle for stability, and the factored polynomial

$$1 - \phi_1 z - \phi_2 z^2 = 0 \quad [2.3.20]$$

whose roots are  $z_{1,2} = \lambda_{1,2}^{-1}$ , and who should lie outside the unit circle for stability (so that  $|z_{1,2}| < 1$ )  
⇒ therefore, to avoid confusion about which roots we're talking about, it's better to talk of eigenvalues.

Nice clarification!

Supp.  $|\lambda_1| < 1$ ,  $|\lambda_2| < 1$  and  $\lambda_1 \neq \lambda_2$ .

then  $(1 - \lambda_1 L)^{-1} = 1 + \lambda_1 L + \lambda_1^2 L^2 + \lambda_1^3 L^3 + \dots$

$$(1 - \lambda_2 L)^{-1} = 1 + \lambda_2 L + \lambda_2^2 L^2 + \lambda_2^3 L^3 + \dots$$

So then the 2<sup>nd</sup> order diff eq, which was

$$(1 - \lambda_1 L)(1 - \lambda_2 L) y_+ = w_+$$

$$\Rightarrow y_+ = (1 - \lambda_1 L)^{-1} (1 - \lambda_2 L)^{-1} w_+$$

From this it is clear that

$$\begin{aligned} y_+ &= w_+ + \lambda_1 w_{t-1} + \lambda_1^2 w_{t-2} + \dots \\ &\quad + w_+ + \lambda_2 w_{t-1} + \lambda_2^2 w_{t-2} + \dots \\ &= \sum_{k=0}^{\infty} \lambda_1^k w_{t-k} + \sum_{k=0}^{\infty} \lambda_2^k w_{t-k}, \text{ or,} \\ &= \sum_{k=0}^{\infty} (\lambda_1^k + \lambda_2^k) w_{t-k} \end{aligned}$$

## 2.5. Initial conditions and unbounded sequences

for a diff eq  $(1 - \phi L) y_t = w_t,$

Sargent's (1987) advice was to solve backward when

$|\phi| < 1$ , multiplying by  $(1 - \phi L)^{-1}$  to get

$$y_t = (1 - \phi L)^{-1} w_t$$

and solve forward when  $|\phi| > 1$ , multiplying by  $(1 - \phi L)^{-1}$  still, but factoring it differently as

$$(1 - \phi L)^{-1} = \frac{-\phi^{-1} L^{-1}}{1 - \phi^{-1} L^{-1}} \quad \text{where } L^{-1} w_t = w_{t+1}$$

$$\Leftrightarrow 1 - \phi^{-1} L^{-1} = -\phi^{-1} L^{-1} (1 - \phi L)$$

$$1 - \phi^{-1} L^{-1} = -\phi^{-1} L^{-1} + 1 \quad \text{ok so they are the same indeed!}$$

$$\text{So then } y_t = \frac{-\phi^{-1} L^{-1}}{1 - \phi^{-1} L^{-1}} w_t$$

$$= (-\phi^{-1} L^{-1}) [1 + \phi^{-1} L^{-1} + \phi^{-2} L^{-2} + \dots] w_t$$

$$= -[\phi^{-1} L^{-1} + \phi^{-2} L^{-2} + \phi^{-3} L^{-3} + \dots] w_t$$

$$= -\sum_{s=1}^{\infty} \left(\frac{1}{\phi}\right)^s w_{t+s} \quad \text{or} = -\frac{1}{\phi} \sum_{s=0}^{\infty} \left(\frac{1}{\phi}\right)^s w_{t+1+s}$$

which is  
EXACTLY  
what Tim  
has

Now I don't know the following: if we can write a scalar diff eq so simply as a function of the AR-coeffs, why doesn't Woodford do that?

I think I know. Sorry: it's b/c technically that's no longer a scalar process: it's a 2<sup>nd</sup> order diff eq.

So maybe in a p-order diff eq case, you follow these steps (more or less) for the particular sol.

1. Decide which  $\lambda_k$  is the dominant one (largest in modulus)
2. Think of the system as a scalar in that and define your lag polynomial accordingly.
3. Factor as you would normally, as fwd- or backward-looking

$$(1 - \lambda_k)^{-1} = \begin{cases} (1 + \lambda_k L + \lambda_k^2 L^2 + \dots) & (\text{bu.}) \\ -(1 + \lambda_k^{-1} L^{-1} + \lambda_k^{-2} L^{-2} + \dots)(\lambda_k^{-1} L^{-1}) & (\text{fw}) \end{cases}$$

So for Woodford's eq we have

$$y_{t+1} = \underbrace{\frac{\alpha}{\beta}}_{\phi_1} y_t - \underbrace{\frac{1}{\beta}}_{\phi_2} y_{t-1} + w_t$$

$$y_t = \phi_1 y_{t-1} + \phi_2 y_{t-2} + w_t$$

$$(1 - \phi_1 L - \phi_2 L^2) y_t = w_t$$

$$(1 - \lambda_1 L)(1 - \lambda_2 L) y_t = w_t$$

$$\begin{matrix} \downarrow & \downarrow \\ \lambda_1 & \lambda_2 \end{matrix}$$

Ignore this

$$y_t = (1 - \lambda_2 L)^{-1} w_t$$

where I use the forward-def of  $(1 - \lambda_2 L)^{-1}$  is

$$\frac{-\lambda_2^{-1} L^{-1}}{1 - \lambda_2^{-1} L^{-1}} = -\lambda_2^{-1} L^{-1} (1 + \lambda_2^{-1} L^{-1} + \lambda_2^{-2} L^{-2} + \dots) w_t$$

$$= -\lambda_2^{-1} (1 + \lambda_2^{-1} L^{-1} + \lambda_2^{-2} L^{-2} + \dots) E_t w_{t-1}$$

$$= -\lambda_2^{-1} \sum_{s=0}^{\infty} (\lambda_2)^{-s} E_t w_{t-1+s} \quad \text{or in Woodford's notation}$$

---


$$- -\mu_2^{-1} \sum_{j=0}^{\infty} (\mu_2)^{-j} E_t w_{t-1+s} \quad \left( \text{use } \frac{1}{\beta} \text{ I still don't know but whatever...} \right)$$


---

$$y_{me}^P = -\mu_2^{-1} \sum_{j=0}^{\infty} (\mu_2)^{-j} E_t w_{t+j+5}$$

ok so we don't quite agree here

$$y_{Woodford}^P = -(\beta^{-1}) \sum_{j=0}^{\infty} (\mu_2)^{-j-1} E_t u_{t+j}$$

(Notes b, p. 40)

and here

but I think it's ok. I know now the essence of what Woodford's solution is made up of and I also know that I can write my 2nd or 3rd order system as

$$(1-\lambda_1 L)(1-\lambda_2 L)(1-\lambda_3 L) y_t = w_t$$

choose the dominant eigenvalue  $\lambda_k$  and write  $(1-\lambda_k L)^{-1}$  as a full- or bw-looking polynomial depending on whether  $|\lambda_k| > 1$  or not.

So I'm still not a 100% sure I see & know 3 March 2020

what Woodford is doing with that 2nd order eq.

But since I might not get to some problem like it unless I can simplify my non-linear equations, I turn to the issue of non-linearity.

In materials 19, take eq (6), which is the root of the non-linearity:

$$f_t - f_{t-1} - k_t^{-1}(\pi_t - f_{t-1}) = 0 \quad (6)$$

$$\Leftrightarrow f_t - f_{t-1} - k_t^{-1}\pi_t + k_t^{-1}f_{t-1} = 0$$

$$\text{try } z_t = \frac{1}{k_t^{-1}}$$

$$f_t - f_{t-1} - \frac{\pi_t}{z_t} + \frac{f_{t-1}}{z_t} = 0$$

Somehow what seems problematic is that the interaction terms (or  $k_t^{-1}$ ) aren't everywhere,

wherefor a guess like  $z_t = \frac{1}{k_t^{-1}}$  fails. Try to reduce the system: (ignore the inputs to  $g(\cdot)$ )

$$(5) \text{ in (3)} : n_+ = kx_+ + \beta f_+ + u_+$$

$$2kx_+ + 2\beta f_+ + 2u_+ + 2\frac{\lambda}{k^2}x_+ - \varphi_+ k_+^{-1} - p_+ g_\pi = 0$$

$$\Rightarrow 2k\left(1 + \frac{\lambda}{k^2}\right)x_+ = \varphi_+ k_+^{-1} + \varphi_+ g_\pi - 2\beta f_+ - 2u_+$$

$$x_+ = \frac{1}{2k\left(1 + \frac{\lambda}{k^2}\right)} (\varphi_+ k_+^{-1} + \varphi_+ g_\pi - 2\beta f_+ - 2u_+)$$

in (4) :

$$\underbrace{-\frac{\beta \frac{\lambda}{k^2}}{2k\left(1 + \frac{\lambda}{k^2}\right)}}_{-\beta \frac{k^2}{1 + \frac{\lambda}{k^2}}} (\varphi_+ k_+^{-1} + \varphi_+ g_\pi - 2\beta f_+ - 2u_+) + \varphi_+ - \varphi_{+1} + \varphi_{+1} k_+^{-1} - \varphi_{+1} g_f = 0$$

$$-\beta \frac{\frac{\lambda}{k^2}}{1 + \frac{\lambda}{k^2}} = -\beta \frac{\lambda}{k^2 + \lambda}$$

$$-\beta \frac{\lambda}{k^2 + \lambda} \varphi_+ k_+^{-1} - \beta \frac{\lambda}{k^2 + \lambda} \varphi_+ g_\pi + 2\beta^2 \frac{\lambda}{k^2 + \lambda} f_+ + 2\beta \frac{\lambda}{k^2 + \lambda} u_+ + \varphi_+ - \varphi_{+1} + \varphi_{+1} k_+^{-1} - \varphi_{+1} g_f = 0$$

$$\text{try } \Delta \varphi_+ = \varphi_+ - \varphi_{+1}$$

$$2\beta^2 \frac{\lambda}{k^2 + \lambda} f_+ + 2\beta \frac{\lambda}{k^2 + \lambda} u_+ + \Delta \varphi_+ + \varphi_{+1} (k_+^{-1} - g_f) - \varphi_+ \beta \frac{\lambda}{k^2 + \lambda} (k_+^{-1} - g_\pi) = 0$$

$$2\beta^2 \frac{\lambda}{k^2 + \lambda} f_+ + 2\beta \frac{\lambda}{k^2 + \lambda} u_+ + \Delta \varphi_+ + \Delta \varphi_{+1} (k_+^{-1} - g_f)$$

the form is the

$$- \varphi_+ \left( \beta \frac{\lambda}{k^2 + \lambda} (k_+^{-1} - g_\pi) + (k_+^{-1} - g_f) \right) = 0$$

same as for (6).

Go back to (6)

$$f_t - f_{t-1} - k_t^{-1}(\pi_t - f_{t-1}) = 0 \quad (6)$$

$$f_t - f_{t-1} - k_t^{-1}\pi_t + k_t^{-1}f_{t-1} = 0$$

Now this is big! !

4 March 2020

Woodford "OMP\_Hbook" - the Opt. Monopol Handbook chapter in the lit-folder of info inflation!

Solves the simple optimal policy problem, & on p. 11 (mac) it arrives at the 2nd order diff eq.

$$E_t \left[ \beta Y_{t+1} - \left( 1 + \beta + \frac{k^2}{\pi} \right) \varphi_t + \varphi_{t-1} \right] = kx^* + u_t \quad (1.12)$$

which gives the characteristic eq

$$\beta \mu^2 - \left( 1 + \beta + \frac{k^2}{\pi} \right) \mu + 1 = 0 \quad (1.13)$$

Using Viète, we have

$$\mu_1 + \mu_2 = -\frac{b}{a} = \frac{1 + \beta + \frac{k^2}{\pi}}{\beta} = \frac{1}{\beta} + 1 + \frac{k^2}{\beta \pi} > 1$$

and

$$\mu_1 \mu_2 = \frac{c}{a} = \frac{1}{\beta} > 1 \Rightarrow \frac{\mu_1}{\mu_2} = \beta^{-1} \mu_2^{-1}$$

Hold on to this

Then we factor (1.12)

$$E_t [\beta(1-\mu_1 L)(1-\mu_2 L) \varphi_{t+1}] = kx^* + u_t$$

(don't know wtf happened to  $(1+\beta + \frac{k^2}{\alpha}) \dots$ )

Multiply by  $(1-\mu_2 L)^{-1} \beta^{-1}$

$$(1-\mu_1 L) \varphi_{t+1} = E_t \beta^{-1} (1-\mu_2^{-1} L^{-1}) (-\mu_2^{-1} L^{-1}) (kx^* + u_t)$$

$$(1-\mu_1 L) \varphi_{t+1} = -\beta^{-1} \mu_2^{-1} E_t (1-\mu_2^{-1} L^{-1}) L^{-1} (kx^* + u_t)$$

$$\Leftrightarrow (1-\mu_1 L) L \varphi_{t+1} = -\beta^{-1} \mu_2^{-1} E_t (1-\mu_2^{-1} L^{-1}) (kx^* + u_t)$$

$$\varphi_t - \mu_1 \varphi_{t-1} = -\mu_1 E_t \sum_{j=0}^{\infty} \mu_2^{-j} (kx^* + u_{t+j})$$

$$\varphi_t = \mu_1 \varphi_{t-1} - \mu_1 E_t \sum_{j=0}^{\infty} \mu_2^{-j} (kx^* + u_{t+j})$$

Now I miss a  $\beta^j$  here.

Like in Hamilton, the eigs replace the AR-coeffs.

$\beta$  seems to stay in here b/c the CB is discounting future stuff, here it's discounting  $\beta^j \varphi_{t+j}$ .

→ so that's why  $\beta$  stays in the eq at the top

- and is reintroduced in the sum at the bottom.

So Woodford wasn't ignoring the smaller role after all! He was factoring smoothly and taking present value.  
So that issue is solved!  
!

Now the other thing is

- optimal paths into NKPC, done
- optimal paths into target criterion, done
- Woodford says in "OMP" that you can back out the optimal paths of  $\pi$  &  $x$  from the FOCs, and putting those into the NKPC you get it for the next step.
- He also says that a policy using the target criterion will do exactly the same thing as the optimal Ramsey policy - the diff. seems to be the communication of the policy. OMP seems not to be feasible to communicate and to implement, whereas a target criterion is.

Now: back to (6)

$$f_t - f_{t-1} - k_t^{-1}(\pi_t - f_{t-1}) = 0 \quad (6)$$

This comes from an "optimal least squares" algorithm along the lines of

$$f_t = f_{t-1} + k_t^{-1}(\pi_t - f_{t-1})$$

But snags. That was something like

$$f_t = f_{t-1} k_t^{-1} \left( \frac{\pi_t}{f_{t-1}} \right)$$

then collecting things  $\ln(x)$

$$\ln(f_t) = \ln(f_{t-1}) + \ln(k_t^{-1}) + \ln(\pi_t) - \ln(f_{t-1})$$

That's not quite cool but: I tried to see if I can find some help on Mathematica. The issue is that a part is linear, a part isn't, and also they're interacting: an unknown is not just a polynomial in itself.

## Ryan meeting

4 March 2020

- Nice insight that TR might be optimal now  
altho it wasn't before!
- guess a sol! & verify
- prob. not going to work
- some way to specify  $g(\cdot)$  such that  
it's slope is exactly right (e.g.  $k_r^{-1}$ )  
so that it all works
- less freedom w/ (b) than w/  $g(\cdot)$ ,  
b/c lots of precedents for TR learning
- continuous time could solve things or make  
things easier: there are only a few theorems  
you need to know (Itô's Lemma and a couple of  
others) and then you're already good to go.  
("functionals".) Wouldn't spend too much time  
on it tho - would instead write up the paper

so that you can 1) benefit from the insights you already have 2) find out while writing what is important, where you need to go deeper etc. And then for one hour a day, find a math textbook and as a hobby, develop your continuous fine math. ( $\leftarrow$  goal there is to see whether a "stat at it" using those tools has a chance of success or not.)

Ricardo Reis: "Each equation has an economic interpretation, et vice versa."

### Work after

To me it seems clear that my most immediate tasks are:

- 1) check on
- 2) write up what you have
- 3) in the meantime, struggle w/ the nonlinear system

Back to our in the mid-simple model of materials 18.

Consider only a cost-prob

shock

same for REL

Step 1. Conjecture  $y_+ = \bar{y} + f_y u_+$  learn.

for all endog. vars  $y = \pi, x, i, f_a, f_b, \bar{\pi}, k^{-1}$

(in material 19,  $y$  would be  $= \pi, x, i, f, k^{-1}$ )

Step 2. Sub conjectures into model equations

and make the deterministic part = 0 = response

to shocks to derive constraints ( $C_i$ )

Step 3. Plug the conjectures into  $\mathcal{L}^{\text{stat}} = \sum_{T=1}^{\infty} \beta^{T-t} [w_t(\pi_t) + \lambda \text{var}_t(x_t)]$

(assuming that the loss function of the CB is the same)

This should give the same  $\mathcal{L}^{\text{stat}}$  as before.

Then  $f_y = \arg\min \mathcal{L}^{\text{stat}}$  s.t. constraints  $C$ :

$$\mathcal{L}^{\text{stat}} = \text{constants} \cdot (f_{\pi}^2 + \lambda f_x^2) \quad (\text{Notes 4, p. 129})$$

Step 4. Coefficient-compare to get the TR-coeffs.

Wait - materials 15 & Notes 5 p. 46 has a good overview!

Materials 15, p. 7-8

Step 1. Postulate conjectures  $z_+ = \bar{z} + f_j u_+ + g_j \hat{r}_j^n$

$j = \pi, x, i$  (and  $f_a, f_b, \bar{\pi}, k^{-1}$ )  $n_y = 7$

where  $u_+, \hat{r}_j^n$  are AR(1)

Step 2. Plug conjectures into model equations to derive

$n_y - 1 = 6$  constraints on the deterministic stuff ( $D_1 - D_6$ )

and  $n_e \cdot (n_y - 1) = 2 \cdot 6 = 12$  constraints on responses to shocks ( $C_1 - C_{12}$ )

Step 3. Solve 3 sets of optimizations:

(a)  $(\bar{\pi}, \bar{x}, \bar{i}, \bar{f}_a, \bar{f}_b, \bar{\pi}, \bar{k}^{-1}) = \arg \min \mathcal{L}^{\text{det}}$  s.t.  $D_1 - D_6$

(b)  $f_j = \arg \min \mathcal{L}^{\text{stab}, u}$  s.t.  $(C_1 - C_{12})^{\text{odd}}$   $j = \pi, x, i, f_a, f_b, \bar{\pi}, k,$

(c)  $g_j = \arg \min \mathcal{L}^{\text{stab}, r}$  s.t.  $(C_1 - C_{12})^{\text{even}}$   $j = \pi, x, i, f_a, f_b, \bar{\pi}, k$

Step 4. Plug one-sol for  $\pi_+ = \bar{\pi} + f_\pi u_+ + g_\pi \hat{r}_\pi^n$

and  $x_+ = \bar{x} + f_x u_+ + g_x \hat{r}_x^n$  into

$$i_+ = \bar{i} + \phi_\pi (\pi_+ - \bar{\pi}) + \phi_x (x_+ - \bar{x}) = \bar{i} + f_i u_+ + g_i \hat{r}_i^n$$

Shortcut: forget about  $\mathcal{L}^{\text{det}}$ , do all of this for

$$i_+ = \phi_\pi \pi_+ + \phi_x x_+ \quad \text{and plug } z_+ = f_j u_+ + g_j \hat{r}_j^n$$

I'm gonna assume that the LR deterministics 5 March 2020  
 stuff are the same as those from RE, ignore those of  
 expectations.

→ Corrected in App. of Draft 2  
 (14 March 2020)

Step 1. Conjecture.

Step 2. Plug into model equations (see materials 18 (9)-(14))

Rewrite model eqs w/ only  $\hat{r}_t^n$  &  $u_t$ -shocks ( $S_+(2)=0$ )

$$\bar{\pi}_t - kx_t - (1-\alpha)\beta f_a(t) - k\alpha\beta b_{21}(1-\alpha\beta\rho_r)^{-1}\hat{r}_t^n - (k\alpha\beta b_{23}+1)(1-\alpha\beta\rho_u)^{-1}u_t = 0 \quad (9)$$

$$x_t + 3u_t - 3f_b(t) + [-(1-\beta)b_{21} + 3\beta b_{31} - 3](1-\beta\rho_r)^{-1}\hat{r}_t^n + [-(1-\beta)b_{23} + 3\beta b_{33}](1-\beta\rho_u)^{-1}u_t = 0 \quad (10)$$

$$f_a(t) - \frac{1}{1-\alpha\beta} \bar{\pi}_{t-1} - b_{11}(1-\alpha\beta\rho_r)^{-1}\hat{r}_t^n - b_{13}(1-\alpha\beta\rho_u)^{-1}u_t = 0$$

$$f_b(t) - \frac{1}{1-\beta} \bar{\pi}_{t-1} - b_{11}(1-\beta\rho_r)^{-1}\hat{r}_t^n - b_{13}(1-\beta\rho_u)^{-1}u_t = 0 \quad (12)$$

$$\hat{\pi}_t - \bar{\pi}_{t-1} - k_t^{-1}(\bar{\pi}_t - \bar{\pi}_{t-1} - b_{11}\hat{r}_t^n - b_{13}u_t) = 0 \quad (13)$$

$$k_t^{-1} - g(\bar{\pi}_t - \bar{\pi}_{t-1} - b_{11}\hat{r}_t^n - b_{13}u_t) = 0 \quad (14)$$

Need to assume some functional form

$$k_t^{-1} - k_{t-1}^{-1} = c + d(\bar{\pi}_t - \bar{\pi}_{t-1} - b_{11}\hat{r}_t^n - b_{13}u_t)$$

$$f_{\bar{r}} u_t + g_{\bar{r}} \hat{r}_t^n - k f_x u_t - k g_x \hat{r}_t^n - (1-\alpha)\beta f_{fa} u_t - (1-\alpha)\beta g_{fa} \hat{r}_t^n \\ - k \alpha \beta b_{21} (1-\alpha \beta \rho_r)^{-1} \hat{r}_t^n - (k \alpha \beta b_{23} + 1) (1-\alpha \beta \rho_n)^{-1} u_t = 0 \quad (9)$$

$$f_x u_t + g_x \hat{r}_t^n + 2 f_i u_t + 2 g_i \hat{r}_t^n - 2 f_{fb} u_t - 2 g_{fb} \hat{r}_t^n \quad (10)$$

$$+ [-(1-\beta)b_{21} + 2\beta b_{31} - 2] (1-\beta \rho_r)^{-1} \hat{r}_t^n + [-(1-\beta)b_{23} + 2\beta b_{33}] (1-\beta \rho_n)^{-1} u_t = 0$$

$$f_{fa} u_t + g_{fa} \hat{r}_t^n - \frac{1}{1-\alpha \beta} f_{\bar{r}} u_{t-1} - \frac{1}{1-\alpha \beta} g_{\bar{r}} \hat{r}_{t-1} - b_{11} (1-\alpha \beta \rho_r)^{-1} \hat{r}_t^n - b_{13} (1-\alpha \beta \rho_n)^{-1} u_t = 0 \quad (11)$$

$$f_{fb} u_t + g_{fb} \hat{r}_t^n - \frac{1}{1-\beta} f_{\bar{r}} u_{t-1} - \frac{1}{1-\beta} g_{\bar{r}} \hat{r}_{t-1} - b_{11} (1-\beta \rho_r)^{-1} \hat{r}_t^n - b_{13} (1-\beta \rho_n)^{-1} u_t = 0 \quad (12)$$

$$f_{\bar{r}} u_t + g_{\bar{r}} \hat{r}_t^n - f_{\bar{r}} u_{t-1} - g_{\bar{r}} \hat{r}_{t-1} - (f_k u_t + g_k \hat{r}_t^n) (f_{\bar{r}} u_t + g_{\bar{r}} \hat{r}_t^n \\ - f_{\bar{r}} u_{t-1} - g_{\bar{r}} \hat{r}_{t-1} - b_{11} \hat{r}_t^n - b_{13} u_t) = 0 \quad (13)$$

$$f_k u_t + g_k \hat{r}_t^n - f_k u_{t-1} - g_k \hat{r}_{t-1} = c + d (f_{\bar{r}} u_t + g_{\bar{r}} \hat{r}_t^n - f_{\bar{r}} u_{t-1} - g_{\bar{r}} \hat{r}_{t-1} \\ - b_{11} \hat{r}_t^n - b_{13} u_t) \quad (14)$$

Group  $u_t$  and  $\hat{r}_t^n$ :

$$[f_{\bar{r}} - k f_x - (1-\alpha)\beta f_{fa} - (k \alpha \beta b_{23} + 1) (1-\alpha \beta \rho_n)^{-1}] u_t \\ + [g_{\bar{r}} - k g_x - (1-\alpha)\beta g_{fa} - k \alpha \beta b_{21} (1-\alpha \beta \rho_r)^{-1}] \hat{r}_t^n = 0 \quad (9)$$

$$[f_x + 2 f_i - 2 f_{fb} + (-1-\beta)b_{23} + 2\beta b_{33}] (1-\beta \rho_n)^{-1} u_t \\ + [g_x + 2 g_i - 2 g_{fb} + (-1-\beta)b_{21} + 2\beta b_{31} - 2] (1-\beta \rho_r)^{-1} \hat{r}_t^n = 0 \quad (10)$$

The troubles start at (11), (12), (13) & (14) when  $u_{t-1}$  &  $\hat{r}_{t-1}$

Show up.

$$\left[ f_{fa} - b_{13}(1-\alpha\beta f_n)^{-1} \right] u_t + \left[ g_{fa} - b_{11}(1-\alpha\beta f_r)^{-1} \right] \hat{r}_t^{nn} - \frac{1}{1-\alpha\beta} f_{\bar{n}} u_{t-1} - \frac{1}{1-\alpha\beta} g_{\bar{n}} \hat{r}_{t-1}^{nn} = 0 \quad (11)$$

$$\left[ f_{fb} - b_{13}(1-\beta f_n)^{-1} \right] u_t + \left[ g_{fb} - b_{11}(1-\beta f_r)^{-1} \right] \hat{r}_t^{nn} - \frac{1}{1-\beta} f_{\bar{n}} u_{t-1} - \frac{1}{1-\beta} g_{\bar{n}} \hat{r}_{t-1}^{nn} = 0 \quad (12)$$

Bigger troubles await at (13) :

$$f_{\bar{n}} u_t + g_{\bar{n}} \hat{r}_t^{nn} - f_{\bar{n}} u_{t-1} - g_{\bar{n}} \hat{r}_{t-1}^{nn} - f_k f_n u_t^2 - f_k g_n u_t \hat{r}_t^{nn} + f_k f_{\bar{n}} u_t u_{t-1} \\ + f_k g_k u_t \hat{r}_t^{nn} + f_k g_{\bar{n}} u_t \hat{r}_{t-1}^{nn} + f_k b_{11} u_t \hat{r}_t^{nn} + f_k b_{13} u_t^2 - g_k f_{\bar{n}} u_t \hat{r}_t^{nn} \\ - g_k g_n (\hat{r}_t^{nn})^2 + g_k f_{\bar{n}} \hat{r}_t^{nn} u_{t-1} + g_k g_{\bar{n}} \hat{r}_t^{nn} \hat{r}_{t-1}^{nn} + g_k b_{11} (\hat{r}_t^{nn})^2 + g_k b_{13} u_t \hat{r}_t^{nn} = 0$$

(13)

$$(f_k - df_n + db_{13}) u_t + (g_k - dg_n + db_{11}) \hat{r}_t^{nn} \\ + (-f_k + df_{\bar{n}}) u_{t-1} + (-g_k + dg_{\bar{n}}) \hat{r}_{t-1}^{nn} = c \quad \begin{matrix} \text{(Possibly)} \\ \underline{\neq 0} \end{matrix} \quad (14)$$

One requirement that solves troubles but may overdo it is

to ask all  $u_{t-1}, \hat{r}_{t-1}^{nn} \stackrel{!}{=} 0$  so that  $f_{\bar{n}} \stackrel{!}{=} 0, g_{\bar{n}} \stackrel{!}{=} 0, f_k = g_k \stackrel{!}{=} 0$

$\rightarrow$  solves (11) & (12), gets rid of (13) and leaves (14) as

$$(-df_n + db_{13}) u_t + (-dg_n + db_{11}) \hat{r}_t^{nn} = c \quad (14)$$

With  $f_{\bar{n}} = g_{\bar{n}} = f_k = g_k = 0$ , we have

$$+ \left[ f_{\bar{n}} - kf_{\bar{x}} - (1-\alpha)\beta f_{fa} - (k\alpha\beta b_{23} + 1)(1-\alpha\beta\rho_n)^{-1} \right] u_+ \stackrel{= C1}{=} C2 \\ + \left[ g_{\bar{n}} - kg_{\bar{x}} - (1-\alpha)\beta g_{fa} - k\alpha\beta b_{21}(1-\alpha\beta\rho_r)^{-1} \right] \hat{r}_t^n = 0 \quad (9)$$

$$+ \left[ f_x + 2f_i - 2f_{fb} + (-1-\beta)b_{23} + 2\beta b_{33} \right] (1-\beta\rho_n)^{-1} u_+ \stackrel{= C3}{=} C3 \\ + \left[ g_x + 2g_i - 2g_{fb} + (-1-\beta)b_{21} + 2\beta b_{31} - b \right] (1-\beta\rho_r)^{-1} r_t^n = 0 \quad (10)$$

$$\left[ f_{fa} - b_{13}(1-\alpha\beta\rho_n)^{-1} \right] u_+ + \left[ g_{fa} - b_{11}(1-\alpha\beta\rho_r)^{-1} \right] \hat{r}_t^n \stackrel{= C4}{=} C4 \\ \stackrel{= C5}{=} C5 \quad \stackrel{= C6}{=} C6 \quad (11)$$

$$\left[ f_{fb} - b_{13}(1-\beta\rho_n)^{-1} \right] u_+ + \left[ g_{fb} - b_{11}(1-\beta\rho_r)^{-1} \right] \hat{r}_t^n \stackrel{= C8}{=} C8 \quad (12)$$

$$\stackrel{= C7}{=} C7 \quad \underbrace{(-df_{\bar{n}} + db_{13})}_{= C9} u_+ + \underbrace{(-dg_{\bar{n}} + db_{11})}_{= C10} \hat{r}_t^n = c \quad (14)$$

which produces 10 restrictions in  $f_{\bar{n}}, f_x, f_{fa}, g_{\bar{n}}, g_x, g_{fa}$

$f_i, f_{fb}, g_i, g_{fb}$  and  $d$  and  $c$  / guess.

Since  $\chi^{stab, u} \propto f_{\bar{n}}^2 + 2x f_x^2 + 2i f_i^2$ ,

wanna plug in these two

so I need 4 constraints to pin down  $f_x, f_i, f_{fa}, f_{fb}$ .

→ Suppose that (14) is just used to pin down  $c$  &  $d$ .

In that case we have the following system of  $f$ 's:

$$f_{\bar{\pi}} - k f_x - (1-\alpha)\beta f_{f_A} - (k\alpha\beta b_{23} + 1)(1-\alpha\beta\rho_n)^{-1} = 0$$

$$f_x + 2f_i - 3f_{f_B} + (-1-\beta)b_{23} + 2\beta b_{33})(1-\beta\rho_n)^{-1} = 0$$

$$f_{f_A} - b_{13}(1-\alpha\beta\rho_n)^{-1} = 0$$

$$f_{f_B} - b_{13}(1-\beta\rho_n)^{-1} = 0$$

$$\Rightarrow f_{\bar{\pi}} - k f_x - (1-\alpha)\beta b_{13}(1-\alpha\beta\rho_n)^{-1} - (k\alpha\beta b_{23} + 1)(1-\alpha\beta\rho_n)^{-1} = 0$$

$$f_x + 2f_i - 3b_{13}(1-\beta\rho_n)^{-1} + (-1-\beta)b_{23} + 2\beta b_{33})(1-\beta\rho_n)^{-1} = 0$$

$$\Rightarrow \underline{f_x = \frac{1}{k} f_{\bar{\pi}} - \frac{(1-\alpha)\beta b_{13}(1-\alpha\beta\rho_n)^{-1} - (k\alpha\beta b_{23} + 1)(1-\alpha\beta\rho_n)^{-1}}{k}}$$

$$\Rightarrow \underline{f_i = -\frac{1}{3} f_x + b_{13}(1-\beta\rho_n)^{-1} - \frac{(-1-\beta)b_{23} + 2\beta b_{33})(1-\beta\rho_n)^{-1}}{3}}$$

$\Rightarrow$  Then we can solve for  $f_{\bar{\pi}}^{\text{ori}}$  from  $L^{\text{stab}, u}$ .

Some interpretation before I do this on Mathematica.

Note from (13) that  $f_k = g_k \stackrel{!}{=} 0$  implies  $f_{\bar{\pi}} = g_{\bar{\pi}} \stackrel{!}{=} 0$ .

$\rightarrow$  "Not conditioning the grain on shocks implies that you're also not conditioning the mean estimate ( $\bar{\pi}$ ) on shocks."

Interestingly  $\mu$ 's doesn't mean that you don't condition long-run  $E(\cdot)$  on shocks. In fact, you do:

$$f_{\pi} = b_{13}(1-\alpha\beta f_n)^{-1}$$

$$g_{\pi} = b_{11}(1-\alpha\beta f_r)^{-1}$$

$$f_b = b_{13}(1-\beta f_n)^{-1}$$

$$g_{fb} = b_m(1-\beta f_r)^{-1}$$

- You want LR- $E(\cdot)$  to respond like the RE to shocks.
- That's why you don't want  $k^*$  &  $\bar{r}$  to respond to shocks at all! Aha! Makes sense!

⇒ Mathematica materials 20.nb

This is insane... I get

$$\psi_{\pi}^* = \frac{k\beta}{\lambda_i} \quad \psi_x^* = \frac{\lambda_x \beta}{\lambda_i} \quad (\text{even if I don't set } f_r = f_n)$$

For RE, I get

$$\phi_{\pi}^* = \frac{k\beta}{\lambda_i} \left( \frac{1}{(\rho-1)(\beta\rho-1) - k\rho\beta} \right)$$

$$\text{E.g. } \beta=1, \rho=0.99, k=0.16$$

$$\lambda_i=0.15, \rho=0.6$$

$$\frac{k\beta}{\lambda_i} \rightarrow 1.066$$

$$0.1624 - 0.096 = 0.0664$$

$$\phi_x^* = \frac{\lambda_x \beta}{\lambda_i} \left( \frac{1-\beta\rho}{(\rho-1)(\beta\rho-1) - \cancel{\lambda_i} k\rho\beta} \right)$$

$$\phi_{\pi}^* = 15.06 \cdot \psi_{\pi}^*.$$

Compare  $\phi_x$  first. Ok, it's 0 if  $\lambda_x = 0$ , and  $\infty$  if  $\lambda \rightarrow 0$   
but in between:

$$\phi_x^* = \psi_x^* \cdot \left( \frac{1 - \beta\rho}{(\rho - 1)(\beta\rho - 1) - K\rho\beta} \right)$$

Is  $\phi_x > \psi_x$ , i.e. is  $1 - \beta\rho > (\rho - 1)(\beta\rho - 1) - K\rho\beta$  ?

$$\Rightarrow 1 - \beta\rho > 1 - \cancel{\beta\rho} - \rho(1 - \beta\rho) - K\rho\beta$$

$$0 > - \left[ \underbrace{\rho(1 - \beta\rho)}_{> 0} + \underbrace{K\rho\beta}_{> 0} \right] \quad \checkmark$$

→ Yes,  $\phi_x^{RE} > \psi_x^{\text{team}}$  if params except  $\rho = 0$ .

Now for  $\phi_\pi$ :

$$\phi_\pi^* = \psi_\pi^* \left( \frac{1}{(\rho - 1)(\beta\rho - 1) - K\rho\beta} \right)$$

Also here: if  $\rho = 0$ ,  $\phi_\pi^* = \psi_\pi^*$ .

Otherwise the question is:  $(\rho - 1)(\beta\rho - 1) - K\rho\beta \geq 1$  ?

$$\beta\rho^2 - \rho - \beta\rho + 1 - K\rho\beta \geq 1 ?$$

$$\rho(\beta\rho - 1 - \beta - K\beta) \geq 0 ? \quad \text{ $\textcircled{< 0}$ } \Rightarrow \phi_\pi^{RE} > \psi_\pi^{\text{team}}$$

Tomorrow should be mainly a writing day:

- The commitment doesn't exist result
- the target criterion for anchoring
- the optimal TR for anchoring

→ less aggressive on inflation: why? b/c

loss-function U-shaped due to anchoring

The only exception is if  $\lambda_i \rightarrow 0$ , then

$$\phi_{\pi}^{\text{EE}} = \psi_{\pi}^{\text{Learn}} \rightarrow \infty$$

↳ Actually it makes sense b/c  $i$ -volatility (and then  $\delta$ ,  $\pi$ -volatility) is one of the costs of anchoring.

To do's based on writing

9 March 2020

- write out diff eq for FE's and dense eqs. They should be an increasing function of the gain.

✓ rewrite intro

✓ type up own for Ryam on Wed.

11 March 2020

- should still write out FE's
- begin looking into estimation

Ryan meeting

11 March 2020

- Start w/ a back-of-the-envelope estimation:  
suppose I wanna match  $\mathbf{x}$  moments: what would  
that function look like: that would be tightly  
parametrized but it would give you a feel  
for what it might look like before doing PF etc.
  - E.g. as you target  $\text{var}(\mathbf{Y})$ ,  $\text{var}(\pi)$  and maybe else  
 $\Rightarrow$  3 parameters fit-at form, & calibrate the  
rest of model.  $\Rightarrow$  don't do high-tech stuff
  - What you want is: get a feel for the anchoring fit: is it concave/convex?  
three empirical targets can pin down 3 free parameters. Calibrate the rest.
  - 1<sup>st</sup> pass empirical exercise in a week
- Alternative: write optimization for  $(\theta_{\mathbf{k}_1}, \mathbf{f}_{\mathbf{x}})$
- $f_2, g_2$  are time-invariant  $\Rightarrow$  that's a problem

- To do's

① FE's

② Start thinking of estimation of very simple

③ Think of time-varying coefficient "oni"

FE's in the original, big model

$$\text{ALM is } z_t = g_{t-1}^l \begin{bmatrix} 1 \\ s_t \end{bmatrix}$$

$$\text{PLM is } \hat{E}_t^m z_{t+1} = \phi_{t-1} s_t \rightarrow \hat{E}_{t-1}^m z_t = \phi_{t-2} s_{t-1} \\ \rightarrow \hat{E}_{t-1}^e z_t^{eve} = \phi_{t-1} \begin{bmatrix} 1 \\ s_{t-1} \end{bmatrix}$$

So the most recent first error is

$$\begin{aligned} f_{t-1} &= z_t - \hat{E}_{t-1}^e z_t^{eve} \\ &= g_{t-1}^l \begin{bmatrix} 1 \\ s_t \end{bmatrix} - \phi_{t-1} \begin{bmatrix} 1 \\ s_{t-1} \end{bmatrix} \\ &= f_{t-1} + G_{t-1} s_t - a_{t-1} - b_{t-1} s_{t-1} \\ &= F_{t-1} - a_{t-1} + [G_{t-1} h_x - b_{t-1}] s_{t-1} \end{aligned}$$

$$\begin{aligned} f_{t-1} &= \left( A_a \frac{1}{1-\alpha\beta} + A_b \frac{1}{1-\beta} \right) a_{t-1} - a_{t-1} \\ &+ \left[ \left( A_a b_{t-1} (\Sigma_3 - \alpha\beta h)^{-1} + A_b b_{t-1} (\Sigma_3 - \beta h)^{-1} + A_s \right) h_x - b_{t-1} \right] s_{t-1} \end{aligned}$$

$$f_{t+1} = \left( A_a \frac{1}{1-\alpha\beta} + A_b \frac{1}{1-\beta} - I_3 \right) a_{t+1} \\ + \left[ [A_a b_{t+1} (I_3 - \alpha\beta h)^{-1} + A_b b_{t+1} (I_3 - \beta h)^{-1} + A_s] h x - b_{t+1} \right] s_{t+1}$$

$$\Rightarrow f_{t+1} = \left( A_a \frac{1}{1-\alpha\beta} + A_b \frac{1}{1-\beta} - I_3 \right) a_{t+1} \\ + \left[ A_a b_{t+1} (I_3 - \alpha\beta h)^{-1} h x + A_b b_{t+1} (I_3 - \beta h)^{-1} h x + A_s h x - b_{t+1} \right] s_{t+1}$$

The problem is that this doesn't make me a lot wiser

b/c 1) diff to pull out  $b_{t+1}$ , 2)  $b_{t+1}$  interacts w/  $s_{t+1}$

$\Rightarrow$  so I can't pinpoint a matrix whose eigenvalues I should study

$\Rightarrow$  But I do know that nonlinear diff eqs can give rise to oscillations for a broader scope of parameters than do linear ones ( $\leftarrow$  complex eigs or  $< 0$  eigs)

Ok. That doesn't help. But I found that FE's were oscillatory even in a simple constant gain setting. So I can take recourse to the very simple model

I use to illustrate the nonlinearity of Ramsey policy:

$$\pi_t = \cancel{k} f_t + \beta f_t + u_t \quad \text{ignore } \cancel{k}$$

$$f_t = f_{t-1} + k^{-1}(\pi_t - f_{t-1})$$

$$\Rightarrow f_t = (1 - k^{-1})f_{t-1} + k^{-1}(\beta f_t + u_t)$$

$$(1 - k^{-1}\beta)f_t = (1 - k^{-1})f_{t-1} + k^{-1}u_t$$

$$f_t = \frac{1 - k^{-1}}{1 - k^{-1}\beta} f_{t-1} + \frac{k^{-1}}{1 - k^{-1}\beta} u_t$$

Aha!

$$k^{-1} \in (0, 1) \quad \beta \in (0, 1) \quad \text{so} \quad k^{-1}\beta < k^{-1}$$

$$1 - k^{-1} < 1 - k^{-1}\beta$$

$$k^{-1} > k^{-1}\beta$$

$$\Rightarrow \frac{1 - k^{-1}}{1 - k^{-1}\beta} < 1$$

✓

$$-k^{-1} < -k^{-1}\beta$$

$$\lim_{\beta \rightarrow 1} = 1$$

$$1 - k^{-1} < 1 - k^{-1}\beta$$

$$FE_{t-1} = \pi_t - f_{t-1}$$

near unit root for  $\beta=0.99$   
 $\Rightarrow \alpha$  is also near unit root

$$= \beta f_t + u_t - f_{t-1}$$

$$= \beta \frac{1 - k^{-1}}{1 - k^{-1}\beta} f_{t-1} + \frac{\beta k^{-1}}{1 - k^{-1}\beta} u_t + u_t - f_{t-1} \quad \underline{13 \text{ March 2020}}$$

$$FE_{t-1} = \left( \beta \frac{1 - k^{-1}}{1 - k^{-1}\beta} - 1 \right) f_{t-1} + \left( 1 + \frac{\beta k^{-1}}{1 - k^{-1}\beta} \right) u_t$$

$$FE_{t-1} = \left( \beta \frac{1-k^{-1}}{1-k^{-1}\beta} - 1 \right) f_{t-1} + \left( 1 + \frac{\beta k^{-1}}{1-k^{-1}\beta} \right) u_t$$

$$FE_{t-1} = \frac{\beta - \beta k^{-1} - 1 + k^{-1}\beta}{1 - k^{-1}\beta} f_{t-1} + \frac{1 - k^{-1}\beta + k^{-1}\beta}{1 - k^{-1}\beta} u_t$$

$$FE_{t-1} = -\frac{1-\beta}{1-k^{-1}\beta} f_{t-1} + \underbrace{\frac{1}{1-k^{-1}\beta}}_{< 1, \lim_{k^{-1} \rightarrow 0} = 1} u_t$$

$$\lambda - \beta < \lambda - k^{-1}\beta \quad | : -\beta$$

$$1 > k^{-1} \quad \checkmark$$

$\Rightarrow$  So FE depends on past expectations with a coefficient that's 1) less than 1 in abs  $\rightarrow$  damped  
2)  $< 0 \Rightarrow$  oscillating

Ok so my two next steps are

19 March 2020

- ① try to generalize one so it allows time-variation
- ② Read Guss, Herbst & Lopez-Salido 2019 to see how they go about estimation  $\rightarrow$  think of it yourself!

## ① Generalizing $\alpha_1$

Well, the problem of time-invariance begins right at the conjecture:  $\hat{z}_t = \bar{z} + f_2 u_1 + g_2 \hat{k}^n$

$$\begin{array}{c} \uparrow \\ \text{These guys are time-invariant} \\ \uparrow \\ \text{by construction!} \end{array}$$

I remember that I previously experimented with treating  $k^n$  and  $\bar{\pi}$  as shocks - but that doesn't quite work if they are endogenous (described by model equations and therefore forecastable to a degree)

↳ so you can only do that if you assume that mnpol doesn't internalize the LOM for  $k$  and  $\bar{\pi}$ .

I'm not sure I like that b/c then mnpol can't internalize its own effects on anchoring.

What I'm dreading to do but I guess we'll have to do

is to simply make 'em time-varying:

$$z_t = \bar{z} + f_{z,t} u_t + g_{z,t} \hat{r}_t^n$$

except for the long-run mean.

This modifies my work from March 5 (p. 5D here) as:

$$\begin{aligned} & [f_{\bar{x},t} - k f_{x,t} - (1-\alpha)\beta f_{fa,t} - (k\alpha\beta b_{23} + \gamma)(1-\alpha\beta\rho_n)^{-1}] u_t \\ & + [g_{\bar{x},t} - k g_{x,t} - (1-\alpha)\beta g_{fa,t} - k\alpha\beta b_{21}(1-\alpha\beta\rho_r)^{-1}] \hat{r}_t^n = 0 \end{aligned} \quad (9)$$

$$\begin{aligned} & [f_{x,t} - 2f_{fx,t} - 2f_{fb,t} + (-(\alpha-\beta)b_{23} + 2\beta b_{33})(1-\beta\rho_n)^{-1}] u_t \\ & + [g_{x,t} - 2g_{fx,t} - 2g_{fb,t} + (-(\alpha-\beta)b_{21} + 2\beta b_{31} - b)(1-\beta\rho_r)^{-1}] r_t = 0 \end{aligned} \quad (10)$$

Only t-subscripts so far, but below the t-1's start

$$\begin{aligned} & [f_{fa,t} - b_{13}(1-\alpha\beta\rho_n)^{-1}] u_t + [g_{fa,t} - b_{11}(1-\alpha\beta\rho_r)^{-1}] \hat{r}_t^n \\ & - \frac{1}{1-\alpha\beta} f_{\bar{x},t+1} u_{t+1} - \frac{1}{1-\alpha\beta} g_{\bar{x},t+1} \hat{r}_{t+1}^n = 0 \end{aligned} \quad (11)$$

$$\begin{aligned} & [f_{fb,t} - b_{13}(1-\beta\rho_n)^{-1}] u_t + [g_{fb,t} - b_{11}(1-\beta\rho_r)^{-1}] \hat{r}_t^n \\ & - \frac{1}{1-\beta} f_{\bar{x},t+1} u_{t+1} - \frac{1}{1-\beta} g_{\bar{x},t+1} \hat{r}_{t+1}^n = 0 \end{aligned} \quad (12)$$

problem is that (11) & (12)  $\rightarrow f_{\bar{x},t+1} = g_{\bar{x},t+1} \stackrel{!}{=} 0$

And like before, even bigger troubles await in (13) & (14):

$$\begin{aligned}
& f_{\bar{\eta}, t} u_t + g_{\bar{\eta}, t} \hat{r}_t^n - f_{\bar{\eta}, t-1} u_{t-1} - g_{\bar{\eta}, t-1} \hat{r}_{t-1}^n = f_{k,t} f_{\bar{\eta}, t} u_t^2 - f_{k,t} g_{\bar{\eta}, t} u_t \hat{r}_t^n + f_{k,t} f_{\bar{\eta}, t-1} u_t u_{t-1} \\
& + f_{k,t} g_{k,t} u_t \hat{r}_t^n + f_{k,t} g_{\bar{\eta}, t-1} u_{t-1} \hat{r}_{t-1}^n + f_{k,t} b_{11} u_t \hat{r}_t^n + f_{k,t} b_{13} u_t^2 - g_{k,t} f_{\bar{\eta}, t} u_t \hat{r}_t^n \\
& - g_{k,t} g_{\bar{\eta}, t} (\hat{r}_t^n)^2 + g_{k,t} f_{\bar{\eta}, t-1} u_{t-1} + g_{k,t} g_{\bar{\eta}, t-1} \hat{r}_t^n \hat{r}_{t-1}^n + g_{k,t} b_{11} (\hat{r}_t^n)^2 + g_{k,t} b_{13} u_t \hat{r}_t^n = 0
\end{aligned}$$

(13)

$$\begin{aligned}
& (f_{k,t} - d f_{\bar{\eta}, t} + d b_{13}) u_t + (g_{k,t} - d g_{\bar{\eta}, t} + d b_{11}) \hat{r}_t^n \\
& + (-f_{k,t-1} + d f_{\bar{\eta}, t-1}) u_{t-1} + (-g_{k,t-1} + d g_{\bar{\eta}, t-1}) \hat{r}_{t-1}^n = c
\end{aligned}$$

(14)

Since (11) & (12) imply that  $f_{\bar{\eta}, t-1} = g_{\bar{\eta}, t-1} \neq 0$ , (13) & (14) become:

$$\begin{aligned}
& f_{\bar{\eta}, t} u_t + g_{\bar{\eta}, t} \hat{r}_t^n - f_{k,t} f_{\bar{\eta}, t} u_t^2 - f_{k,t} g_{\bar{\eta}, t} u_t \hat{r}_t^n + \\
& + f_{k,t} g_{k,t} u_t \hat{r}_t^n + f_{k,t} b_{11} u_t \hat{r}_t^n + f_{k,t} b_{13} u_t^2 - g_{k,t} f_{\bar{\eta}, t} u_t \hat{r}_t^n \\
& - g_{k,t} g_{\bar{\eta}, t} (\hat{r}_t^n)^2 + g_{k,t} b_{11} (\hat{r}_t^n)^2 + g_{k,t} b_{13} u_t \hat{r}_t^n = 0
\end{aligned}$$

(13)

$$\begin{aligned}
& (f_{k,t} - d f_{\bar{\eta}, t} + d b_{13}) u_t + (g_{k,t} - d g_{\bar{\eta}, t} + d b_{11}) \hat{r}_t^n \\
& + (-f_{k,t-1} \quad \quad \quad ) u_{t-1} + (-g_{k,t-1} \quad \quad \quad ) \hat{r}_{t-1}^n = c
\end{aligned}$$

(14)

Which reduces to:

$$\begin{aligned}
 & f_{\bar{\pi},+} u_t + g_{\bar{\pi},+} \hat{r}_t^n + \left( f_{k,+} + f_{\pi,+} + f_{k,+} b_{13} \right) u_t^2 + \left( g_{k,+} b_{11} - g_{k,+} g_{\pi,+} \right) \hat{r}_t^{n^2} \\
 & + \left( -f_{k,+} g_{\pi,+} - f_{k,+} g_{k,+} + f_{k,+} b_{11} - g_{k,+} f_{\pi,+} + g_{k,+} b_{13} \right) u_t \hat{r}_t^n = 0
 \end{aligned} \tag{13}$$

$$\begin{aligned}
 & \left( f_{k,+} - d f_{\pi,+} - d b_{13} \right) u_t + \left( g_{k,+} - d g_{\pi,+} - d b_{11} \right) \hat{r}_t^n \\
 & - f_{k,+} u_{t-1} - g_{k,+} \hat{r}_{t-1}^n = c
 \end{aligned} \tag{14}$$

$$\Rightarrow (13) \text{ implies } f_{\bar{\pi},+} = g_{\bar{\pi},+} \stackrel{!}{=} 0$$

So so far we have  $f_{\bar{\pi},+} = g_{\bar{\pi},+} \stackrel{!}{=} 0$   $\forall t$  and given that,

$$f_{z,+} = f_z \quad \forall t \quad \text{and} \quad g_{z,+} = g_z \quad \forall t \quad \text{for } z = \pi, x, i, f_a, f_b$$

Rewrite again:

*my feeling is that  $f_{\bar{\pi},+}$  &  $g_{\bar{\pi},+}$  is determined in the rest of the system (eqs. (5) & (10))*

so  $f_{k,+} \stackrel{!}{=} g_{k,+} \stackrel{!}{=} 0$ . Which kills

$$\begin{aligned}
 & f_{k,+} \left( b_{13} - f_{\pi,+} \right) u_t^2 + g_{k,+} \left( b_{11} - g_{\pi,+} \right) \hat{r}_t^{n^2} \\
 & + \left( f_{k,+} \left( b_{11} - g_{\pi,+} \right) + f_{k,+} g_{k,+} + g_{k,+} \left( b_{13} - f_{\pi,+} \right) \right) u_t \hat{r}_t^n = 0
 \end{aligned} \tag{13}$$

$$\begin{aligned}
 & \left( f_{k,+} + d \left( b_{13} - f_{\pi,+} \right) \right) u_t + \left( g_{k,+} + d \left( b_{11} - g_{\pi,+} \right) \right) \hat{r}_t^n \\
 & - f_{k,+} u_{t-1} - g_{k,+} \hat{r}_{t-1}^n = c
 \end{aligned} \tag{14}$$

$\Rightarrow (14)$  becomes:

$$d(b_{13} - f_{\pi,t}) u_t + d(b_{11} - g_{\pi,t}) \hat{r}_t^n - f_{k,t-1} u_{t-1} - g_{k,t-1} \hat{r}_{t-1}^n = c$$

If  $c=0$ , then  $d = f_{k,t-1} = g_{k,t-1} \neq 0$  (I think...)

But that ( $d=0$ ) cannot be!

What is a problem, though, is that this seems to impose an additional constraint but in 2 unknowns!

$\Rightarrow$  type other like this up!

Supp  $c=0$ ,  $d \neq 0$ .

$$d(b_{13} - f_{\pi,t}) u_t - f_{k,t-1} u_{t-1} = 0$$

$$\Rightarrow f_{k,t-1} = d(b_{13} - f_{\pi,t}) \frac{u_t}{u_{t-1}}$$

$$\Rightarrow g_{k,t-1} = d(b_{11} - g_{\pi,t}) \frac{\hat{r}_t^n}{\hat{r}_{t-1}^n}$$

(m) anchoring RE response of  $\pi$  to  $\hat{r}^n$  an response of  $\pi$  to  $\hat{r}^n$  ratio of today's & yesterday's shock

Somewhat what we want is not something of the form

15 March 2020

$$z_t = f_1 u_t + k_t f_2 u_t \quad \text{should arise}$$

endogenously, just not in a discord fashion.

→ so maybe the interaction terms aren't so bad after all!

But there seems to be a bigger problem b/c somehow eqs (9)-(10) are disconnected from (13)-(14) b/c  $f_a$  &  $f_b$  reduce to RE in any case - they shouldn't.

→ the problem is  $\text{stuff}_1 \cdot u_t + \text{stuff}_2 \cdot u_{t-1}$   
which forces  $\text{stuff}_1 = 0$  and  $\text{stuff}_2 = 0$ .

So what if I said

$$\bar{z}_t = \bar{z} + f_{2,t} u_t + g_{2,t} r_t \quad \text{for } z_t = \pi_t, x_t, i_t, f_a(t), f_b(t), k_t^{-1}$$

AND  $\bar{\pi}_{t-1}$

The main diff will be to eq (11)-(12), the ones is  $f_a, f_b, \bar{\pi}$ .  
(Also (13) will change.)

$$f_{fa,t} u_t + g_{fa,t} \hat{r}_t^n - \left( \frac{1}{1-\alpha\beta} \right) (f_{\bar{\pi},t} u_t + g_{\bar{\pi},t} \hat{r}_t^n)$$

$$-b_{13}(1-\alpha\beta\rho_n)^{-1}u_t - b_{11}(1-\alpha\beta\rho_r)^{-1}\hat{r}_t^n = 0 \quad (11)$$

$\Rightarrow$

$$\left[ f_{fa,t} - \frac{1}{1-\alpha\beta} f_{\bar{\pi},t} - b_{13}(1-\alpha\beta\rho_n)^{-1} \right] u_t + \left[ g_{fa,t} - \frac{1}{1-\alpha\beta} g_{\bar{\pi},t} - b_{11}(1-\alpha\beta\rho_r)^{-1} \right] \hat{r}_t^n = 0 \quad (11)$$

$$\left[ f_{fb,t} - \frac{1}{1-\beta} f_{\bar{\pi},t} - b_{13}(1-\beta\rho_n)^{-1} \right] u_t + \left[ g_{fb,t} - \frac{1}{1-\beta} g_{\bar{\pi},t} - b_{11}(1-\beta\rho_r)^{-1} \right] \hat{r}_t^n = 0 \quad (12)$$

Ok, this would link  $f_a, f_b$  to  $f_{\bar{\pi}}$ , and thereby  $f_n, f_x, f_i$  too!

(4) is the same. (13) becomes:

$$\begin{aligned} & f_{\bar{\pi},t+1} u_{t+1} + g_{\bar{\pi},t+1} \hat{r}_{t+1}^n - f_{\bar{\pi},t} u_t - g_{\bar{\pi},t} \hat{r}_t^n \\ & - (f_{k,t} u_t + g_{k,t} \hat{r}_t^n) (f_{\bar{\pi},t} u_t + g_{\bar{\pi},t} \hat{r}_t^n - f_{\bar{\pi},t} u_t - g_{\bar{\pi},t} \hat{r}_t^n - b_{11} \hat{r}_t^n - b_{13} u_t) \\ & = 0 \end{aligned}$$

$$\begin{aligned} & f_{\bar{\pi},t+1} \rho_n u_t + g_{\bar{\pi},t+1} \rho_r \hat{r}_t^n - f_{\bar{\pi},t} u_t - g_{\bar{\pi},t} \hat{r}_t^n \\ & - (f_{k,t} u_t + g_{k,t} \hat{r}_t^n) ((f_{\bar{\pi},t} - f_{\bar{\pi},t} \cdot b_{13}) u_t + (g_{\bar{\pi},t} - g_{\bar{\pi},t} \cdot b_{11}) \hat{r}_t^n) = 0 \quad (13) \end{aligned}$$

$$f_{\bar{\pi},t+1} \rho_u u_t + g_{\bar{\pi},t+1} \rho_r \hat{r}_t^n - f_{\bar{\pi},t} u_t - g_{\bar{\pi},t} \hat{r}_t^n \\ - (f_{k,t} u_t + g_{k,t} \hat{r}_t^n) \left( (f_{\pi,t} - f_{\bar{\pi},t} - b_{13}) u_t + (g_{\pi,t} - g_{\bar{\pi},t} - b_{11}) \hat{r}_t^n \right) = 0$$

$\Leftrightarrow$

$$(\rho_u f_{\bar{\pi},t+1} - f_{\bar{\pi},t}) u_t + (\rho_r g_{\bar{\pi},t+1} - g_{\bar{\pi},t}) \hat{r}_t^n \\ - f_{k,t} (f_{\pi,t} - f_{\bar{\pi},t} - b_{13}) u_t^2 - g_{k,t} (g_{\pi,t} - g_{\bar{\pi},t} - b_{11}) (\hat{r}_t^n)^2 \\ + [-f_{k,t} (g_{\pi,t} - g_{\bar{\pi},t} - b_{11}) - g_{k,t} (f_{\pi,t} - f_{\bar{\pi},t} - b_{13})] u_t \hat{r}_t^n = 0$$

Implications: 1)  $\rho_u f_{\bar{\pi},t+1} = f_{\bar{\pi},t}$

shit... that means  $f_{\bar{\pi}}$  is growing over time ...

2)  $f_{k,t} (f_{\pi,t} - f_{\bar{\pi},t} - b_{13}) = 0$

$$\Rightarrow \begin{cases} f_{k,t} = 0 & \text{or} \\ f_{\pi,t} = f_{\bar{\pi},t} + b_{13} \end{cases} \quad \leftarrow \text{I guess I wanna avoid that.} \quad \leftarrow \text{and this makes sense}$$

Not cool.

So what if we want beyond this simple conditioning on  $t$ ?

the first time-varying attempt was

$z_t = f_{2,t} u_t$ , saying that the optimal response of  $z$  at time  $t$  to  $u_t$  is  $f_{2,t}$ .

the second was

$z_t = f_{2,t} u_t$  for  $z_t = \pi_t, x_t, i_t, f_a(t), f_b(t), k_t^{-1}, \underline{\bar{\pi}_{t+1}}$

↳ In a way I don't like this b/c it's saying that  $\bar{\pi}_{t+1}$  can respond at  $t$ , which ain't true.

What if I instead allowed  $z_t$  to respond to  $u_t$  and  $u_{t-1}$ ?

$$z_t = f_{2,t} u_t + f_{2,t-1} u_{t-1}$$

$$\text{or } z_t = f_2 u_t + f_{2,L} u_{t-1}$$

Cool but this is time-invariant.

So a third could be

$$z_t = f_{2,t} u_t + f_{2,t}^L u_{t-1}$$

↳ Let's again look at (1)-(2) first!

Ignore  $\hat{r}_t^n$  for a sec!

$$f_{fa,t} u_t + f_{fa,t}^L u_{t-1} - \frac{1}{1-\alpha\beta} \left( f_{\bar{\pi},t-1} u_{t-1} + f_{\bar{\pi},t-1}^L u_{t-2} \right)$$

$$- b_{13} (1 - \alpha\beta p_n)^{-1} u_t = 0$$

$$\Rightarrow \left( f_{fa,t} - b_{13} (1 - \alpha\beta p_n)^{-1} \right) u_t + \left( f_{fa,t}^L - \frac{1}{1-\alpha\beta} f_{\bar{\pi},t-1} \right) u_{t-1} + f_{\bar{\pi},t-1}^L u_{t-2} = 0$$

Implications: 1)  $f_{\bar{\pi},t-1}^L = 0 \rightarrow$  makes sense?

2)  $f_{fa,t} = b_{13} (1 - \alpha\beta p_n)^{-1} \rightarrow$  dam, RE again.

3)  $f_{fa,t}^L = \frac{1}{1-\alpha\beta} f_{\bar{\pi},t-1} \rightarrow$  makes sense I guess..

Let's see (13)! (w/o  $\hat{r}_t^n$ )

$$\begin{aligned} & f_{\bar{\pi},t} u_t + f_{\bar{\pi},t}^L u_{t-1} - f_{\bar{\pi},t-1} u_{t-1} - f_{\bar{\pi},t-1}^L u_{t-2} \\ & - (f_{k,t} u_t + f_{k,t}^L u_{t-1}) (f_{\pi,t} u_t + f_{\pi,t}^L u_{t-1} - f_{\bar{\pi},t-1} u_{t-1} - f_{\bar{\pi},t-1}^L u_{t-2} \\ & - b_{13} u_t) = 0 \end{aligned}$$

$$\begin{aligned} & \Rightarrow f_{\bar{\pi},t} u_t + (f_{\bar{\pi},t}^L - f_{\bar{\pi},t-1}) u_{t-1} - f_{\bar{\pi},t-1}^L u_{t-2} - (f_{k,t} u_t + f_{k,t}^L u_{t-1}) \times \\ & \left( (f_{\pi,t} - b_{13}) u_t + (f_{\pi,t}^L - f_{\bar{\pi},t-1}) u_{t-1} - f_{\bar{\pi},t-1}^L u_{t-2} \right) = 0 \end{aligned}$$

## INTERMEZZO

Supp  $\hat{r_t^n} = 0 \quad \forall t$  so all  $g_i = 0$ .

$$i_t = \gamma_{\pi} (\pi_t - \bar{\pi}) + \gamma_x (x_t - \bar{x}) + \bar{i}_t$$

$$= \bar{i}_t + f_i u_t$$

$$= \gamma_{\pi} (f_{\pi} u_t) + \gamma_x f_x u_t + \bar{i}_t$$

$$= \underbrace{(\gamma_{\pi} f_{\pi} + \gamma_x f_x)}_{f_i} u_t + \bar{i}_t$$

→ wouldn't be enough to pin down 2 params.

If  $f_t^n$  doesn't ex, we can only have a 2-param

Taylor-like like:  $i_t = \gamma_{\pi} \pi_t + \bar{i}_t$

$$= \gamma_{\pi} f_{\pi} u_t + \bar{i}_t$$

$$i_t = f_i u_t + \bar{i}_t$$

$$\Rightarrow \gamma_{\pi} f_{\pi} = f_i \quad \Leftrightarrow \quad \underline{\underline{\gamma_{\pi} = \frac{f_i}{f_{\pi}}}}$$

Strange thing is,  $\gamma_{\pi}$  in RE (materials15.nb) is much more complicated now than it was before.

$$f_{\bar{\pi},t} u_t + \left( f_{\bar{\pi},t}^L - f_{\bar{\pi},t-1} \right) u_{t-1} - f_{\bar{\pi},t-1}^L u_{t-2} - \left( f_{K,t} u_t + f_{K,t}^L u_{t-1} \right) \times$$

$$\left( \left( f_{\bar{\pi},t} - b_{13} \right) u_t + \left( f_{\bar{\pi},t}^L - f_{\bar{\pi},t-1} \right) u_{t-1} - f_{\bar{\pi},t-1}^L u_{t-2} \right) = 0$$

$$\Rightarrow f_{\bar{\pi},t} u_t + \left( f_{\bar{\pi},t}^L - f_{\bar{\pi},t-1} \right) u_{t-1} - \underbrace{f_{\bar{\pi},t-1}^L}_{- f_{K,t} \left( f_{\bar{\pi},t} - b_{13} \right) u_t^2 - f_{K,t} \left( f_{\bar{\pi},t}^L - f_{\bar{\pi},t-1} \right) u_t u_{t-1} + f_{K,t} f_{\bar{\pi},t-1}^L u_t u_{t-2}} u_{t-2}$$

$$- f_{K,t} \left( f_{\bar{\pi},t} - b_{13} \right) u_t^2 - f_{K,t} \left( f_{\bar{\pi},t}^L - f_{\bar{\pi},t-1} \right) u_t u_{t-1} + f_{K,t} \underbrace{f_{\bar{\pi},t-1}^L}_{- f_{K,t} \left( f_{\bar{\pi},t} - b_{13} \right) u_t u_{t-1} - f_{K,t} \left( f_{\bar{\pi},t}^L - f_{\bar{\pi},t-1} \right) u_{t-1}^2 - f_{K,t} f_{\bar{\pi},t-1}^L u_{t-1} u_{t-2}} u_{t-2} = 0$$

$$\text{Use } f_{\bar{\pi},t-1}^L = 0$$

$$\Rightarrow f_{\bar{\pi},t} u_t + \left( f_{\bar{\pi},t}^L - f_{\bar{\pi},t-1} \right) u_{t-1}$$

$$- f_{K,t} \left( f_{\bar{\pi},t} - b_{13} \right) u_t^2 - f_{K,t} \left( f_{\bar{\pi},t}^L - f_{\bar{\pi},t-1} \right) u_t u_{t-1}$$

$$- f_{K,t} \left( f_{\bar{\pi},t} - b_{13} \right) u_t u_{t-1} - f_{K,t} \left( f_{\bar{\pi},t}^L - f_{\bar{\pi},t-1} \right) u_{t-1}^2 = 0$$

$$f_{\bar{\pi},t} \stackrel{!}{=} 0$$

$$\Rightarrow \left( f_{\bar{\pi},t}^L - f_{\bar{\pi},t-1} \right) u_{t-1} - f_{K,t} \left( f_{\bar{\pi},t} - b_{13} \right) u_t^2 - f_{K,t} \left( f_{\bar{\pi},t}^L - f_{\bar{\pi},t-1} \right) u_{t-1}^2$$

$$+ \left[ - f_{K,t} \left( f_{\bar{\pi},t}^L - f_{\bar{\pi},t-1} \right) - f_{K,t} \left[ f_{\bar{\pi},t} - b_{13} \right] \right] u_t u_{t-1} = 0$$

You know, I don't know about that.

16 March 2020

- I wanna pause on for a sec b/c I can't seem to get it to work and I'm confused about how to get it time-varying anyway. So let's move to estimation.