Robert B. Barsky began by responding to some of the issues raised by the discussants, Franck Portier and Lawrence J. Christiano. He noted that the essence of the disagreement between his paper and Portier’s comments concerns whether total factor productivity (TFP) rises along with other measures of economic activity, or whether it rises only after those other measures. He agreed that the issue of confidence intervals, raised by Christiano in his presentation, was a concern. He also speculated that imposing a Bayesian prior might be a useful approach.

Barsky argued that in an RBC model, declines in hours and investment predicted by the model in response to a news shock were modest. Furthermore, along with his co-authors, he had estimated a low degree of stickiness in a sticky-price model of news shocks. An RBC model captures the notion that news shocks are not very expansionary in the short run, and quite expansionary later.

Michael Woodford spoke next, clarifying the issue of inflation determination and the Taylor principle in the RBC model. In that model, output is determined independently of monetary policy, and it is as if there was an exogenously specified shift term in the monetary policy reaction function. That reaction function is one in which the nominal interest rate is a function of the lagged nominal interest rate, the inflation rate, and the aforementioned exogenous shift term. If the shift term tracks the natural rate of interest, stable inflation would result. If the coefficient on output growth (the shift term) were large enough, interest rates would rise when output goes up by more than the natural rate and cause disinflation. Because inflation is forward looking, it is a function not just of the gap between the real rate and the natural rate in the current period, but also the anticipated path of that gap. If a news shock
causes price-setters to anticipate several quarters of positive output growth and tighter monetary policy as a result of that growth, it will cause immediate disinflation at the time of impact. Disinflation occurs not because the nominal rate is lowered when the shock occurs, but because of the anticipation that nominal rates will be raised in the future. Woodford pointed out that this is consistent with the beliefs expressed by Christiano in his presentation, and clarified that the authors’ calibration of the RBC model satisfied the Taylor principle.

Tarek Hassan spoke next, rhetorically asking, “Why care about news shocks?” He suggested that in the presence of news shocks, policy should have an additional objective, allowing people to adjust in response to their knowledge of the future as quickly as possible. He pointed out that this type of adjustment could have an effect on the overall level of economic activity, not just its dynamics.

George-Marios Angeletos mentioned that he has been doing some empirical work on news shocks, and encountered some difficulties that might also be problematic for the authors’ VARs. In comparing the responses of investment and hours to realized TFP shocks and news shocks, but looking at the point in time after TFP has increased in response to a news shock, Angeletos found that the VAR impulse responses could be very different. Angeletos claimed that in some models this is not possible because once a news shock has become an TFP shock the impulse responses should be the same. He argues that it is difficult to interpret the VAR because it is not consistent with the model in this way.

Robet B. Barsky suggested that this kind of issue invites some sort of Bayesian estimation procedure for the VAR, and George-Marios Angeletos agreed. Angeletos expressed this idea in a different form, saying that there are some identifying restrictions from the model that are violated by the VAR. He found something similar in New Keynesian and RBC models with news shocks by generating artificial data and then running VARs. It was very difficult for him to match the impulse responses from those artificial-data VARs to the ones from a VAR on the actual data.

George-Marios Angeletos also made a comment about the variance decomposition presented by the authors. In the impulse responses there is a small response in hours and investment, but a large response in consumption. He pointed out that this is very hard to interpret, at least in a closed-economy model, and that it raises concerns about the quality of the identification.
Michael Kiley spoke next, expressing concerns about the sample period used by the authors. He first noted that their sample encompasses the zero-lower-bound period, and while it is a small part of their sample, his work (Chung et al. 2014) illustrates that different models make different predictions about the response to news shocks when the zero lower bound binds. He also expressed concern that the authors’ results about inflation would not be robust to using a smaller sample period. Robert B. Barsky confirmed that the inflation results were indeed not robust to splitting the sample. Kiley also mentioned that in other work (Boivin et al. 2010), he found that VAR estimates changed before and after the Volcker disinflation. He argued that while it is convenient to use all the data, when the data shows a structural break this is not appropriate.

Mark Gertler then inquired about whether the authors had examined the relative importance of news shocks in each recession. He argued that explaining the causes of recessions is more interesting than explaining the “wiggles” outside of recessions. Gertler felt that the news shock story fit the 2001 recession best and thought that the news shock literature arose in response to that recession. He then spoke about other recessions, such as the recent one, and asked whether there was a role for news shocks in explaining the cause of those recessions. Robert B. Barsky responded that there was only a small role for news shocks in the recent recession.

Guido Lorenzoni suggested a different approach to the data. If the researcher knew the determinants of the natural rate of interest, he or she could predict what inflation should be, instead of using the Taylor rule. Lorenzoni also noted that this would be an interesting approach to the estimation of government spending multipliers.

Franck Portier responded by noting that tracking the natural rate is equivalent, in New Keynesian models, to replicating the flexible price equilibrium. In those models, he claimed, the natural rate actually goes down when there is good news. He argued that the flexible-price model underlying a sticky-price model should exhibit a positive response of the natural rate to news shocks, and mentioned a paper of his (Beaudry and Portier 2013) in which he develops such a model.

Susanto Basu thanked the discussants for their enormous amount of work and helpful suggestions. With respect to George-Marios Angeletos’ concerns about identification, he noted that their identification procedure looks only at the behavior of TFP at a specific future horizon. Following up on Mark Gertler’s question, Basu noted that news
shocks are important around the 1970s to the mid-1980s and, in particular, the 1974–1975 recession. The authors found this interesting, and were initially concerned that this finding might imply that news shocks and oil shocks were being confounded. However, the authors found that their result was robust to including oil prices early in the VAR as exogenous variables.