Abstract

This thesis studies the nature of the interrelationships between the United States and the euro area by examining the relative importance of foreign and domestic monetary policy shocks. We estimate two vector autoregression models using seven variables on a period running from 1999 until 2016. These models differ only in the selection of interest rates: the first model contains the standard interest rates, while the other contains the Wu-Xia shadow rates in order to better account for unconventional monetary policies at the zero lower bound. We examine the magnitude and the persistence of interest rates shocks using impulse response analysis. We subsequently focus our attention on forecast error variance decompositions.

The results from both models indicate that monetary contractions lead to decreases in economic activity and price level in consistence with economic theory, with substantial evidence for mutual monetary policy dependence given the cross-border spillovers indicated by the impulse responses. Furthermore, using Wu-Xia shadow rates produces results that indicate more persistent reactions of economic activity to interest rate shocks, which is in accordance with the stated goals of unconventional monetary policies to engender economic recovery after the financial crisis.

Keywords

Vector autoregression, monetary policy, United States, euro area, impulse responses, forecast error variance decomposition, shadow interest rates

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