The SVAR package

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February 18, 2015

Contents

1 Introduction

The `SVAR` package is a collection of gretl scripts to estimate Structural VARs, or SVARs for short. In order to establish notation and define a few concepts, allow me to inflict on you a 2-page crash course on SVARs.[1]

We call "structural" a model in which we assume that the one-step-ahead prediction errors ε_t from a statistical model can be thought of as linear functions of the *structural shocks* u_t. In its most general form, a structural model is the pair of equations

$$\begin{aligned} \varepsilon_t &= y_t - E(y_t|\mathcal{F}_{t-1}) && (1) \\ A\varepsilon_t &= Bu_t && (2) \end{aligned}$$

In practically all cases, the statistical model is a a finite-order VAR and equation (1) specialises to

$$y_t = \mu' x_t + \sum_{i=1}^{p} A_i y_{t-i} + \varepsilon_t \qquad \text{or} \qquad A(L)y_t = \mu' x_t + \varepsilon_t \tag{3}$$

where the VAR may include an exogenous component x_t, which typically contains at least a constant term. The above model is referred to as the AB-model in Amisano-Giannini (1997).

The object of estimation are the square matrices A and B; estimation is carried out by maximum likelihood. After defining C as $A^{-1}B$, under the assumption of normality the average log-likelihood can be written as

$$\mathcal{L} = \text{const} - \ln|C| - 0.5 \cdot \text{tr}(\hat{\Sigma}(CC')^{-1})$$

As is well known, the above model is under-identified and in order for the log-likelihood to have a (locally) unique maximum, it is necessary to impose some restrictions on the matrices A and B. This issue will be more thoroughly discussed in section 6; for the moment, let's just say that some the elements in A and B have to be fixed to pre-specified values. The minimum number of restrictions is $n^2 + \frac{n^2-n}{2}$. This, however, is a necessary condition, but not sufficient by itself.

The popular case in which $A = I$ is called a C-model. Further, a special case of the C-model occurs when B is assumed to be lower-triangular. This was Sims's (1980) original proposal, and is sometimes called a "recursive" identification scheme. It has a number of interesting properties, among which the fact that the ML estimator of C is just the Cholesky decomposition of $\hat{\Sigma}$, the sample covariance matrix of VAR residuals. This is why many practitioners, including myself, often use the "recursive model" and "Cholesky model" phrases interchangeably. This has been the most frequently used variant of a SVAR model, partly for its ease of interpretation, partly for its ease of estimation.[2] In the remainder of this document, a lower-triangular C model will be called a "plain" SVAR model.

[1] I'll try to follow the notation used in Amisano and Giannini (1997) as closely as possible.

[2] Some may say "partly for the unimaginative nature of applied economists, who prefer to play safe and maximise the chances their paper isn't rejected rather than risk and be daring and creative". But who are we to judge?

If the model is just-identified, $\hat{\Sigma}(CC')^{-1}$ will be the identity matrix and the log-likelihood simplifies to

$$\mathcal{L} = \text{const} - 0.5 \ln |\hat{\Sigma}| - 0.5n$$

Of course, it is possible to estimate constrained models by placing some extra restrictions; this makes it possible to test the over-identifying restrictions easily by means of a LR test.

Except for trivial cases, like the Cholesky decomposition, maximisation of the likelihood involves numerical iterations. Fortunately, analytical expressions for the score, the Hessian and the information matrix are available, which helps a lot;[3] once convergence has occurred, the covariance matrix for the unrestricted elements of A and B is easily computed via the information matrix.

Once estimation is completed, $\hat{A}$ and $\hat{B}$ can be used to compute the structural VMA representation of the VAR, which is the base ingredient for most of the subsequent analysis, such as Impulse Response Analysis and so forth. If the matrix polynomial $A(L)$ in eq. (3) is invertible, then (assuming $x_t = 0$ for ease of notation), y_t can be written as

$$y_t = A(L)^{-1}\varepsilon_t = \Theta(L)\varepsilon_t = \varepsilon_t + \Theta_1\varepsilon_{t-1} + \cdots$$

which is known as the VMA representation of the VAR. Note that in general the matrix polynomial $\Theta(L)$ is of infinite order.

From the above expression, one can write the *structural* VMA representation as

$$y_t = Cu_t + \Theta_1 Cu_{t-1} + \cdots = M_0 u_t + M_1 u_{t-1} + \cdots \tag{4}$$

From eq. (4) it is immediate to compute the impulse response functions:

$$\mathcal{I}_{i,j,h} = \frac{\partial y_{i,t}}{\partial u_{j,t-h}} = \frac{\partial y_{i,t+h}}{\partial u_{j,t}}$$

which in this case equal simply

$$\mathcal{I}_{i,j,h} = [M_h]_{ij}$$

The computation of confidence intervals for impulse responses could, in principle, be performed analytically by the delta method (see Lütkepohl (1990)). However, this has two disadvantages: for a start, it is quite involved to code. Moreover, the limit distribution has been shown to be a very poor approximation in finite samples (see for example Kilian (1998)), so the bootstrap is almost universally adopted, although in some cases it may be quite CPU-heavy.

Another quantity of interest that may be computed from the structural VMA representation is the Forecast Error Variance Decomposition (FEVD). The forecast error variance after h steps is given by

$$\Omega_h = \sum_{k=0}^{h} M_k M_k'$$

[3] As advocated in Amisano and Giannini, the scoring algorithm is used by default, but several alternatives are available. See subsection 2.2 below.

hence the variance for variable i is

$$\omega_i^2 = [\Omega_h]_{i,i} = \sum_{k=0}^{h} e_i' M_k M_k' e_i = \sum_{k=0}^{h} \sum_{l=1}^{n} ({}_k m_{i.l})^2$$

where e_i is the i-th selection vector[4], so ${}_k m_{i.l}$ is, trivially, the i, l element of M_k. As a consequence, the share of uncertainty on variable i that can be attributed to the j-th shock after h periods equals

$$\mathcal{VD}_{i,j,h} = \frac{\sum_{k=0}^{h} ({}_k m_{i.j})^2}{\sum_{k=0}^{h} \sum_{l=1}^{n} ({}_k m_{i.l})^2}.$$

2 C models

2.1 A simple example

```
# turn extra output off
set echo off
set messages off

# open the data and do some preliminary transformations
open sw_ch14.gdt
genr infl = 400*ldiff(PUNEW)
rename LHUR unemp
list X = unemp infl

var 3 unemp infl

Sigma = $sigma
C = cholesky(Sigma)
print Sigma C
```

Table 1: Cholesky example via the internal `gretl` command

As a trivial example, we will estimate a plain Cholesky model. The data are taken from Stock and Watson's sample data `sw_ch14.gdt`, and our VAR will include inflation and unemployment, with a constant and 3 lags. Then, we will compute the IRFs and their 90% bootstrap confidence interval[5].

2.1.1 Gretl native `var` command

In order to accomplish the above, note that we *don't* need to use the `SVAR` package, as a Cholesky SVAR can be handled by `gretl` natively. In fact, the script shown in Table 2.1 does just that: runs a VAR, collects $\hat{\Sigma}$ and estimates C as its Cholesky deomposition. Part of its output is in Table 2.1. The impulse responses as computed by `gretl`'s internal command can be see in figure 1. See the Gretl's User Guide for more details.

[4] That is, a vector with zeros everywhere except for a 1 at the i-th element.

[5] Why not 95%? Well, keeping the number of bootstrap replications low is one reason. Anyway, it must be said that in the SVAR literature few people use 95%. 90%, 84% or even 66% are common choices.

```
VAR system, lag order 3
OLS estimates, observations 1960:1-1999:4 (T = 160)
Log-likelihood = -267.76524
Determinant of covariance matrix = 0.097423416
AIC = 3.5221
BIC = 3.7911
HQC = 3.6313
Portmanteau test: LB(40) = 162.946, df = 148 [0.1896]

Equation 1: u

             coefficient   std. error   t-ratio   p-value
  ---------------------------------------------------------
  const       0.137300     0.0846842     1.621    0.1070
  u_1         1.56139      0.0792473    19.70     8.07e-44 ***
  u_2        -0.672638     0.140545     -4.786    3.98e-06 ***

...
Sigma (2 x 2)

    0.055341    -0.028325
   -0.028325       1.7749

C (2 x 2)

     0.23525       0.0000
    -0.12041       1.3268
```

Table 2: Cholesky example via the internal `gretl` command — Output

2.1.2 Base estimation via the `SVAR` package

We will now replicate the above example via the `SVAR` package; in order to do so, we need to treat this model as a special case of the C-model, where $\varepsilon_t = Cu_t$ and identification is attained by stipulating that C is lower-triangular, that is

$$C = \begin{bmatrix} c_{11} & 0 \\ c_{12} & c_{22} \end{bmatrix}. \tag{5}$$

Table 3 shows a sample script to estimate the example Cholesky model: the basic idea is that the model is contained in a gretl bundle[6]. In this example, the bundle is called `Mod`, but it can of course take any valid `gretl` identifier.

After performing the same preliminary steps as in the example in Table 2.1, we load the package and use the `SVAR_setup` function, which initialises the model and sets up a few things. This function takes 4 arguments:

- a string, with the model type (`"C"` in this example);

[6]Bundles are a gretl data type: they may be briefly described as containers in which a certain object (a scalar, a matrix and so on) is associated to a "key" (a string). Technically speaking, a bundle is an associative array: these data structures are called "hashes" in Perl or "dictionaries" in Python. Fore more info, you'll want to take a look at the Gretl's User Guide, section 11.7.

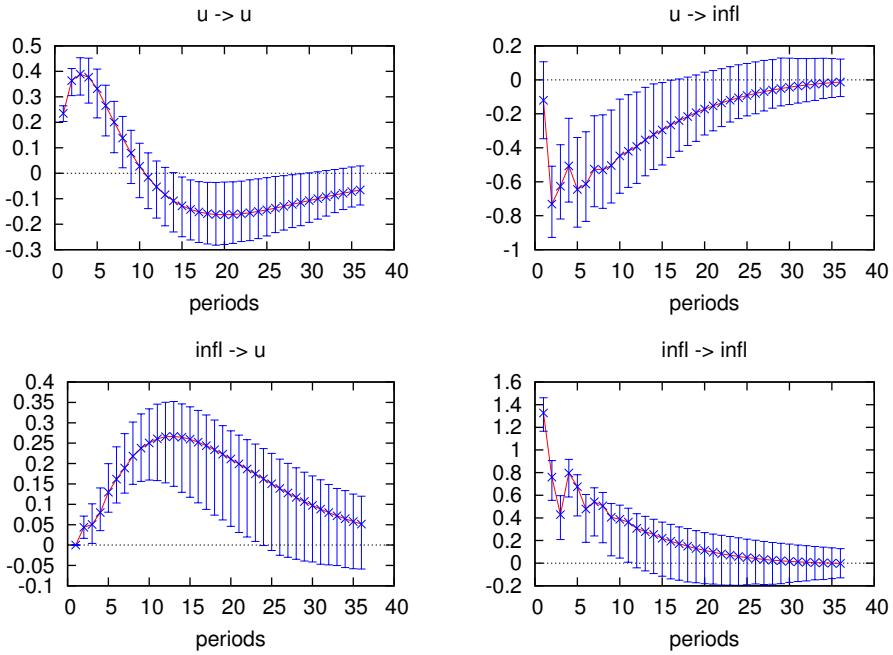


Figure 1: Impulse response functions for the simple Cholesky model (native)

```
# turn extra output off
set echo off
set messages off

# open the data and do some preliminary transformations
open sw_ch14.gdt
genr infl = 400*ldiff(PUNEW)
rename LHUR unemp
list X = unemp infl
list Z = const

# load the SVAR package
include SVAR.gfn

# set up the SVAR
Mod = SVAR_setup("C", X, Z, 3)

# Specify the constraints on C
SVAR_restrict(&Mod, "C", 1, 2, 0)

# Estimate
SVAR_estimate(&Mod)
```

Table 3: Simple C-model

- a list containing the endogenous variables y_t;
- a list containing the exogenous variables x_t (may be `null`);
- the VAR order p.

Once the model is set up, you can specify which elements you want to constrain to achieve identification; there are several ways to do this, but in most cases you'll want to use the `SVAR_restrict` function. A complete description can be found in appendix A; suffice it to say here that the result of the function

```
SVAR_restrict(&Mod, "C", 1, 2, 0)
```

is to ensure that $C_{1,2} = 0$ (see eq. 5).

The next step is estimation, which is accomplished via the `SVAR_estimate` function, which just takes one argument, the model to estimate. The output of the `SVAR_estimate` function is shown below[7]: note that, as an added benefit, we get asymptotic standard errors for the estimated parameters (estimated via the information matrix).

```
Unconstrained Sigma:
     0.05676    -0.02905
    -0.02905     1.82044

             coefficient   std. error   z-stat    p-value
  ---------------------------------------------------------
  C[ 1; 1]     0.238243    0.0131548    18.11     2.62e-73 ***
  C[ 2; 1]    -0.121939    0.105142     -1.160    0.2461
  C[ 1; 2]     0.00000     0.00000      NA        NA
  C[ 2; 2]     1.34371     0.0741942    18.11     2.62e-73 ***
```

At this point, the model bundle contains all the quantities that will need to be accessed later on, including the structural VMA representation (4), which is stored in a matrix called `IRFs` inside the bundle which has h rows and n^2 columns. Each row i of this matrix is $\text{vec}(M_i)'$, so if you wanted to retrieve the IRF for variable m with respect to the shock k, you'd have to pick its $[(k-1) \cdot n + m]$-th column.

The number of rows h is called the "horizon". The function `SVAR_setup` initalises automatically the horizon to 24 for monthly data and to 20 for quarterly data. To change it, you just assign the desired value to the `"horizon"` element of the bundle, as in (for example)

```
Mod["horizon"] = 40
```

It goes without saying that this adjustment as to be done *before* the `SVAR_estimate` function is called.

More details on the internal organisation of the bundle can be found in section B in the appendix. Its contents can be accessed via the ordinary gretl syntactic constructs for dealing with bundles. For example, the number of observations used in estimating the model is stored as the bundle member `"T"`, so if you ever need it you can just use the syntax `Mod["T"]`, or `Mod.T` with newer versions of gretl (from 1.9.12 onwards).

[7] For compatibility with other packages, $\hat{\Sigma}$ is estimated by dividing the cross-products of the VAR residuals by $T - k$ instead of T; this means that the actual figures will be slightly different from what you would obtain by running `var` and then `cholesky($sigma)`.

2.2 Algorithm choice

Another thing you may want to toggle before calling `SVAR_estimate` is the optimisation method: you do this by setting the bundle element `optmeth` to some number between 0 and 4; its meaning is shown below:

optmeth	Algorithm
0	BFGS (numerical score)
1	BFGS (analytical score)
2	Newton-Raphson (numerical score)
3	Newton-Raphson (analytical score)
4	Scoring algorithm (**default**)

So in practice the following code snippet

```
Mod["optmeth"] = 3
SVAR_estimate(&Mod)
```

would estimate the model by using the Newton-Raphson method, computing the Hessian by numerically differentiating the analytical score. In most cases, the default choice will be the most efficient; however, it may happen (especially with heavily over-identified models) that the scoring algorithm fails to converge. In those cases, there's no general rule. Experiment!

2.3 Impulse responses and FEVD

```
fevdmat = FEVD(&Mod)
print fevdmat

IRFplot(&Mod, 1, 1)
```

Table 4: Simple C-model (continued)

As shown in Table 4, after the model has been estimated, it can be passed to another function called `FEVD` to compute the Forecast Error Variance Decomposition, which is subsequently printed. Its usage is very simple, since it only needs one input (a pointer to the model bundle).

The `SVAR` package provides a function called `IRFplot` for plotting the impulse response function on your screen, with a little help from our friend `gnuplot`; its syntax is relatively simple.[8] The three arguments used here are:

1. The model bundle (as a pointer);
2. the number of the structural shock we want the IRF to;
3. the number of the variable we want the IRF for.

[8]There is a parallel function for the FEVD. See section A in the Appendix.

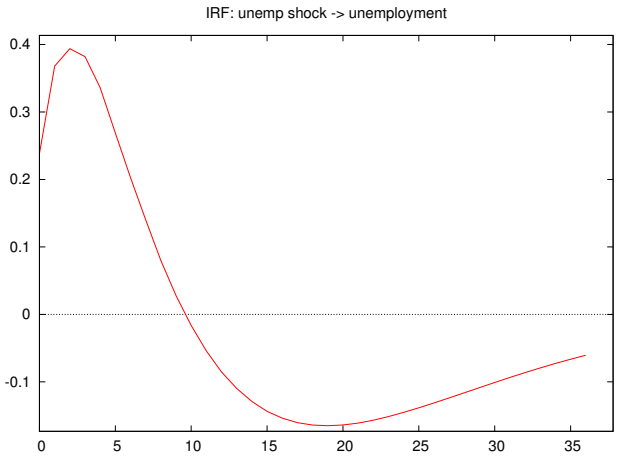


Figure 2: Impulse response functions for unemployment

The function can be used in a more sophisticated way than this (see later). Its output is presented in Figure 2. As can be seen, it's very similar to the one obtained by `gretl`'s native command (Figure 1).[9]

2.4 Bootstrapping

```
bfail = SVAR_boot(&Mod, 1024, 0.90)

loop for i=1..2 -q
    loop for j=1..2 -q
        sprintf fnam "simpleC_%d%d.pdf", i, j
        IRFsave(fnam, &Mod, i, j)
    end loop
end loop
```

Table 5: Simple C-model (continued)

The next step is computing bootstrap-based confidence intervals for the estimated coefficients and, more interestingly, for the impulse responses: as can

[9]Warning: using the built-in GUI graph editor that gretl provides may produce 'wrong' results on the figures generated by the `IRFplot` function. All gretl's graphics are handled by creating a gnuplot script, executing it and then sending the result to the display. All this is done transparently. When you edit a graph, you modify the underlying gnuplot script via some GUI elements, so when you click "Apply" the graphic gets re-generated. However, gretl's GUI interface for modifying graphics can't handle arbitrary gnuplot scripts, but only those generated internally.

The figures generated by `IRFplot` contain a few extra features that the GUI editor doesn't handle, so invoking the GUI controls may mess up the graph. As an alternative, you can customise the graph by editing the gnuplot script directly: right-click on it and "Save [it] to session as icon". Then, in the icon view, right click on the graph icon and choose "Edit plot commands": you'll have the gnuplot source to the graph, that you can modify as needed.

be seen in Table 5, this task is given to the `SVAR_boot` function, which takes as arguments

1. The model bundle pointer;
2. the required number of bootstrap replications (1024 here)[10]
3. the desired size of the confidence interval α.

The function outputs a scalar, which keeps track of how many bootstrap replications failed to converge (none here). Note that this procedure may be quite CPU-intensive. The output contains a table similar to the output to `Cmodel`, which is used to display the bootstrap means and standard errors of the parameters:

```
Bootstrap results (1024 replications)
             coefficient   std. error      z       p-value
  ------------------------------------------------------------
  C[ 1; 1]     0.232146    0.0183337    12.66      9.57e-37 ***
  C[ 2; 1]    -0.114610    0.143686     -0.7976    0.4251
  C[ 1; 2]     0.00000     0.00000      NA        NA
  C[ 2; 2]     1.30234     0.0853908    15.25      1.61e-52 ***

Failed = 0, Time (bootstrap) = 20.24
```

Once the bootstrap is done, its results are stored into the bundle for later use: upon successful completion, the model bundle will contain a matrix called `bootdata`, internally organised as follows: the first row contains some information on the bootstrap details; from the second row down you get 3 submatrices in which each column is one of the n^2 IRFs, and the rows contain

1. the lower limit of the confidence interval in the first block of $h + 1$ rows
2. the upper limit of the confidence interval in the second block of $h + 1$ rows
3. the medians in the second block of $h + 1$ rows.

where h is the IRF horizon.

In practice, the bootstrap results may be retrieved as follows (the medians in this example):

```
bfail = SVAR_boot(&Mod, 1024, 0.90)
scalar h = Mod["horizon"]
matrix m = Mod["bootdata"]
scalar begrow = 1 + (h+1)*2 + 1
scalar endrow = 1 + (h+1)*3
matrix medians = m[begrow:endrow,]
```

However, if you invoke `IRFplot()` after the bootstrap, the above information will be automatically used for generating the graph. Another `SVAR` function, `IRFsave()`, is used to store plots the impulse responses into graphic files files

[10] There's a hard limit at 10000 at the moment; probably, it will be raised in the future. However, unless your model is very simple, anything more than that is likely to take forever and melt your CPU.

for later use[11] ; its arguments are the same as `IRFplot()`, except that the first argument must contain a valid filename to save the plot into. In the above example, this function is used within a loop to save all impulse responses in one go. The output is shown in Figure 3.

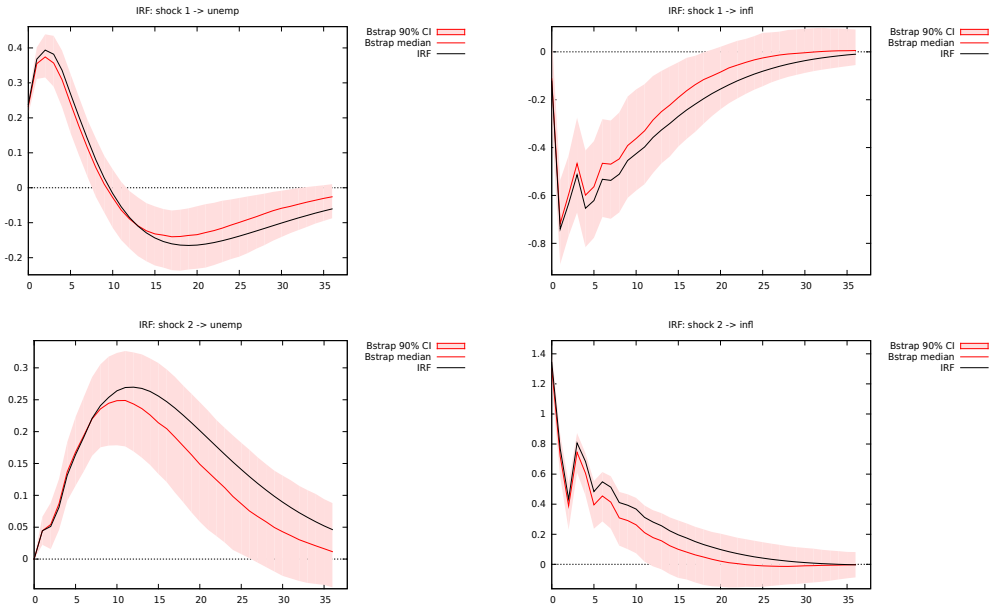


Figure 3: Impulse response functions for the simple Cholesky model

The default method for performing the bootstrap is the the most straightforward, that is the one put forward by Runkle (1987). As an alternative, one may use the bias-correction procedure known as "bootstrap-after-bootstrap" (Kilian, 1998). This may be enabled by setting the bundle member `biascorr` to a non-zero value before calling `SVAR_boot`.[12] None of the fancier alternatives listed, for example, in Brüggemann (2006) are available. They are planned, though.

Finally: if you change the `optmeth` bundle element before `SVAR_boot` is called, the choice affects the estimation of the bootstrap artificial models. Hence, you may use one method for the real data and another method for the bootstrap, if you so desire.

2.5 A shortcut

In many cases, a triangular, Cholesky-style specification for the C matrix like the one analysed in this section is all that is needed. When many variables are involved, the setting of the $\frac{n\times(n-1)}{2}$ restrictions via the `SVAR_restrict` function could be done quite boring, although easily done via a loop.

For these cases, the `SVAR` package provides an alternative way: if you supply the `SVAR_setup` function with the string `"plain"` as its first argument, the

[11] The format is dictated by the extension you use for the output file name: since this job is delegated to `gnuplot`, all graphical formats that `gnuplot` supports are available, including pdf, PostScript (via the extension `ps`) or PNG (via the extension `png`).

[12] For an example, look at the example file `bias_correction.inp`.

necessary restrictions are set up automatically. Thus, the example considered above in Table 3 could by modified by replacing the lines

```
Mod = SVAR_setup("C", X, Z, 3)
SVAR_restrict(&Mod, "C", 1, 2, 0)
```

with the one-liner

```
Mod = SVAR_setup("plain", X, Z, 3)
```

and leaving the rest unchanged. Of course, when you have two variables, such as in this case, there's no much difference, but for larger systems the latter syntax is much more convenient.

Another advantage is that, in this case, the solution to the likelihood maximisation problem is known analytically, so no numerical optimisation technique is used at all. This makes computations much faster, and for example allows you to make extravagant choices on, for example, the number of bootstrap replications. Hence, if your C model is amenable to be written as a plain triangular model, it is highly advisable to do so.

2.6 Specifying restrictions

A key ingredient in a SVAR (arguably, *the* key ingredient) is the set of constraints we put on the structural matrices. `SVAR` handles these restrictions via their implicit form representation $R\theta = d$. Consider, for notational convenience, the matrix $R^* = [R|d]$. The `SVAR_restrict` function we used earlier does nothing but adding rows to R^*. The function also contains a check so that redundant or inconsistent restrictions will not be allowed.

For a C model, the R^* matrix is stored as the bundle element `Rd1` and the number of its rows is kept as bundle element `nc1`. If you feel like building the matrix R^* via gretl's ordinary matrix functions, all you have to do is to fill up the bundle elements `Rd1` and `nc1` properly before calling `SVAR_estimate()`.

2.7 Retrieving the structural shocks

Once the model has been estimated, it becomes possible to retrieve estimates of the structural shocks, via the function `GetShocks`, as in:

```
series foo = GetShock(&Mod, 1)
series bar = GetShock(&Mod, 2)
```

If we append the two lines above to example 3, two new series will be obtained. The formula used is nothing but equation (10) in which the VAR residuals are used in place of ε_t.

2.8 The GUI interface

Most of the above can be accomplished via the GUI interface, which can be accessed via the *Model > Time Series > Structural VAR* menu entry of the the graphical gretl client. While we recommend to use the script interface to use the full capabilities of the SVAR package, the GUI interface may be less intimidating for less experienced users.

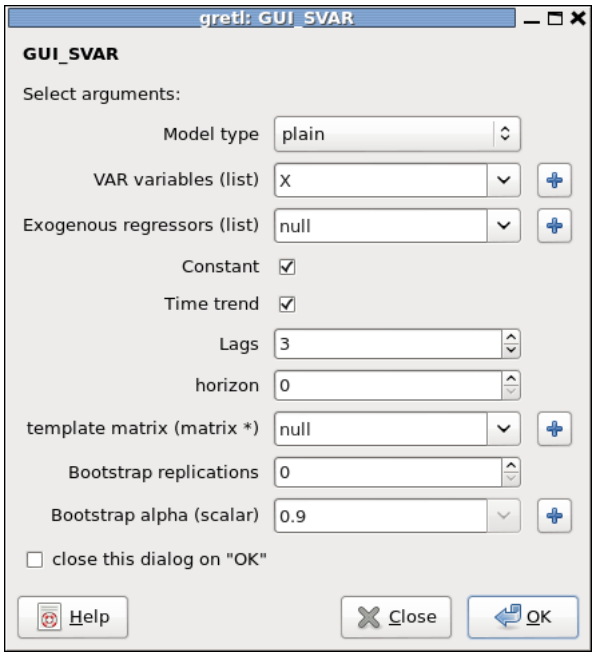


Figure 4: Plain Cholesky model through the GUI interface

The contents of the window displayed in figure 4 should be rather self-explanatory, with one exception, that is the "template" matrix. This can be used for estimating C models with a restriction scheme other than the lower diagonal one.

For example, suppose we wanted to estimate a C model like the one used as example so far, with the only difference that we want the C matrix to be *upper* triangular, rather than lower trangular. Via a script, you would use the function `SVAR_restrict()`, as in

```
# Force C_{2,1} to 0
SVAR_restrict(&Mod, "C", 2, 1, 0)
```

but you can do the same via the GUI interface by using a template matrix. A template matrix is a $n \times n$ matrix (that is, the same size as C) which contains valid numerical values for the corresponding restricted elements of C and NAs for unrestricted elements.

This can be a pre-existing matrix or a matrix you define on the spot by clicking on the "+" button. In this case, you'll be presented with gretl's GUI window for creating matrices. Suppose we call the template matrix `TMPL` and that we select the option "Build Numerically" (of course, with 2 rows and 2 columns in this example). A further window will appear, that you can use for filling the matrix elements with the desired values, as in Figure When you're done, you return to the main SVAR window (be sure to select C-model as the model type). After clicking "OK", the results window will appear, as in Figure 6. Note that the estimated C matrix is now upper triangular.

From the output window, you can save the model bundle to the Icon view

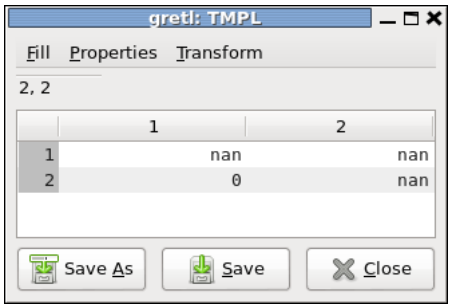


Figure 5: Template matrix

by clicking on the leftmost icon[13] and re-use it as needed for further processing.

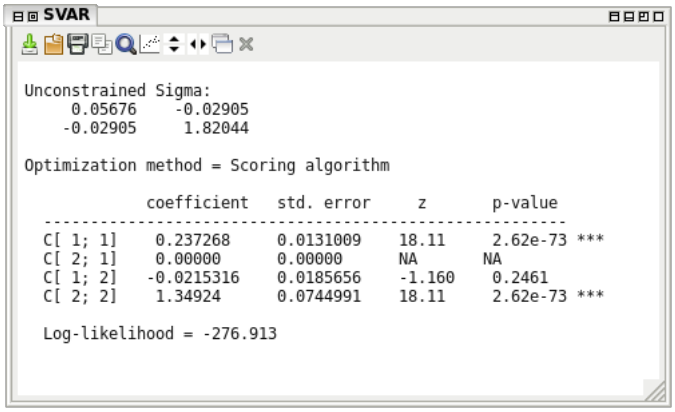


Figure 6: Output window

3 C-models with long-run restrictions (Blanchard-Quah style)

An alternative way to impose restrictions on C is to use long-run restrictions, as pioneered by Blanchard and Quah (1989). The economic rationale of imposing restictions on the elements of C is that C is equal to M_0, the instantaneous IRF. For example, Cholesky-style restrictions mean that the j-th shock has no instantaneous impact on the i-th variable if $i < j$. Assumptions of this kind are normally motivated by institutional factors such as sluggish adjustments, information asymmetries, and so on.

Long-run restrictions, instead, stem from more theoretically-inclined reasoning: in Blanchard and Quah (1989), for example, it is argued that in the long

[13]The visual appeareance of the icons on your computer may be different from the one shown in Figure 5, as they depend on your software setup; the screenshots in this document, for example, were generated with different Linux graphical widgets and themes. The ordering of the icons, however, should be the same on all systems.

```
set echo off
set messages off
include SVAR.gfn
open BlQuah.gdt

list X = DY U
list exog = const time
maxlag = 8

# set up the model
BQModel = SVAR_setup("C", X, exog, maxlag)
BQModel["horizon"] = 40

# set up the long-run restriction
SVAR_restrict(&BQModel, "lrC", 1, 2, 0)

# cumulate the IRFs for variable 1
SVAR_cumulate(&BQModel, 1)

# set up names for the shocks
BQModel["snames"] = "Supply Demand"

# do estimation
SVAR_estimate(&BQModel)

# retrieve the demand shocks
dShock = GetShock(&BQModel, 2)

# bootstrap
bfail = SVAR_boot(&BQModel, 1024, 0.9)

# page 662
IRFsave("bq_Yd.pdf", &BQModel,  1, 1)
IRFsave("bq_ud.pdf", &BQModel, -2, 1)
IRFsave("bq_Ys.pdf", &BQModel,  1, 2)
IRFsave("bq_us.pdf", &BQModel, -2, 2)
```

Table 6: Blanchard-Quah example

run the level of GDP is ultimately determined by aggregate supply. Fluctuations in aggregate demand, such as those induced by fiscal/monetary policy, impact the level of GDP only in the short term. As a consequence, the impulse response of GDP with respect to demand shocks should go to 0 asymptotically, whereas the response of GDP to a supply shock shoud settle to some positive value.

3.1 A modicum of theory

To translate this intuition into formulae, assume that the bivariate process GDP growth-unemployment

$$x_t = \begin{bmatrix} \Delta Y_t \\ U_t \end{bmatrix}$$

is $I(0)$ (which implies that Y_t is $I(1)$), and that it admits a finite-order VAR representation

$$A(L)x_t = \varepsilon_t$$

where the prediction errors are assumed to be a linear combination of demand and supply shocks

$$\begin{bmatrix} \varepsilon_t^{\Delta Y} \\ \varepsilon_t^{U} \end{bmatrix} = C \begin{bmatrix} u_t^d \\ u_t^s \end{bmatrix},$$

Considering the structural VMA representation

$$\begin{aligned} \begin{bmatrix} \Delta Y_t \\ U_t \end{bmatrix} &= \Theta(L)\varepsilon_t = \varepsilon_t + \Theta_1\varepsilon_{t-1} + \cdots = \\ &= Cu_t + \Theta_1 C u_{t-1} + \cdots = M_0 u_t + M_1 u_{t-1} + \cdots, \end{aligned}$$

it should be clear that the impact of demand shocks on ΔY_t after h periods is given by the north-west element of M_h. Since x_t is assumed to be stationary, $\lim_{h\to\infty} \Theta_h = 0$ and the same holds for M_k, so obviously the impact of either shock on ΔY_t goes to 0. However, the impact of u_t on the *level* of Y_t is given by the *sum* of the corresponding elements of M_h, since

$$Y_{t+h} = Y_{t-1} + \sum_{i=0}^{h} \Delta Y_{t+i},$$

so

$$\frac{\partial Y_{t+h}}{\partial u_t^d} = \sum_{i=0}^{h} \frac{\partial \Delta Y_{t+i}}{\partial u_t^d} = \sum_{i=0}^{h} [M_i]_{11}$$

and in the limit

$$\lim_{h\to\infty} \frac{\partial Y_{t+h}}{\partial u_t^d} = \sum_{i=0}^{\infty} \frac{\partial \Delta Y_{t+i}}{\partial u_t^d} = \sum_{i=0}^{\infty} [M_i]_{11},$$

In general, if x_t is stationary, the above limit is finite, but needn't go to 0; however, if we assume that the long-run impact of u_t^d on Y_t is null, then

$$\lim_{k\to\infty} \frac{\partial Y_{t+k}}{\partial u_t^d} = 0$$

and this is the restriction we want. In practice, instead of constraining elements of M_0, we impose an implicit constraint on the whole sequence M_i.

How do we impose such a constraint? First, write $\sum_{i=0}^{\infty} \Theta_i$ as $\Theta(1)$; then, observe that

$$\Theta(1)C = \sum_{i=0}^{\infty} M_i;$$

the constraint we seek is that the north-west element of $\Theta(1)C$ equals 0. The matrix $\Theta(1)$ is easy to compute after the VAR coefficients have been estimated: since $\Theta(L) = A(L)^{-1}$, an estimate of $\Theta(1)$ is simply

$$\widehat{\Theta(1)} = \hat{A}(1)^{-1}$$

Of course, for this to work $A(1)$ needs to be invertible. This rules out processes with one or more unit roots. The cointegrated case, however, is an interesting related case and will be analysed in section 7.

The long-run constraint we seek can then be written as

$$R \operatorname{vec}[\Theta(1)C] = 0, \tag{6}$$

where $R = [1, 0, 0, 0]$; since

$$\operatorname{vec}[\Theta(1)C] = [I \otimes \Theta(1)] \operatorname{vec}(C),$$

the constraint can be equivalently expressed as

$$[\Theta(1)_{11}, \Theta(1)_{12}, 0, 0] \operatorname{vec}(C) = \Theta(1)_{11} \cdot c_{11} + \Theta(1)_{12} \cdot c_{21} = 0. \tag{7}$$

Note that we include in R elements that, stictly speaking, are not constant, but rather functions of the estimated VAR parameters. Bizarre as this may seem, this poses no major inferential problems under a suitable set of conditions (see Amisano and Giannini (1997), section 6.1).

```
            coefficient   std. error      z       p-value
  ------------------------------------------------------------
  C[ 1; 1]    0.0575357    0.0717934      0.8014   0.4229
  C[ 2; 1]    0.217542     0.0199133     10.92     8.80e-28 ***
  C[ 1; 2]   -0.907210     0.0507146    -17.89     1.45e-71 ***
  C[ 2; 2]    0.199459     0.0111501     17.89     1.45e-71 ***

Bootstrap results (1000 replications)

            coefficient   std. error      z      p-value
  ------------------------------------------------------------
  C[ 1; 1]     0.232452    0.285316      0.8147   0.4152
  C[ 2; 1]     0.191064    0.0786388     2.430    0.0151   **
  C[ 1; 2]    -0.829021    0.113861     -7.281    3.31e-13 ***
  C[ 2; 2]     0.222009    0.0648956     3.421    0.0006   ***
```

Table 7: Output for the Blanchard-Quah model

3.2 Example

The way all this is handled in `SVAR` is hopefully quite intuitive: an example script is reported in Table 6. After reading the data in, the function `SVAR_setup` is invoked in pretty much the same way as in section 2.

Then, the `SVAR_restrict` is used to specify the identifying restriction. Note that in this case the code for the restriction type is `"lrC"`, which indicates that the restriction applies to the long-run matrix, so the formula (7) is employed. Next, we insert into the model the information that we will want IRFs for y_t, so those for Δy_t will have to be cumulated. This is done via the function `SVAR_cumulate()`, in what should be a rather self-explanatory way (the number 1 refers in this case to the position of ΔY_t in the list `X`). Finally, a cosmetic touch: we store into the model the string `"Supply Demand"`, which will be used to label

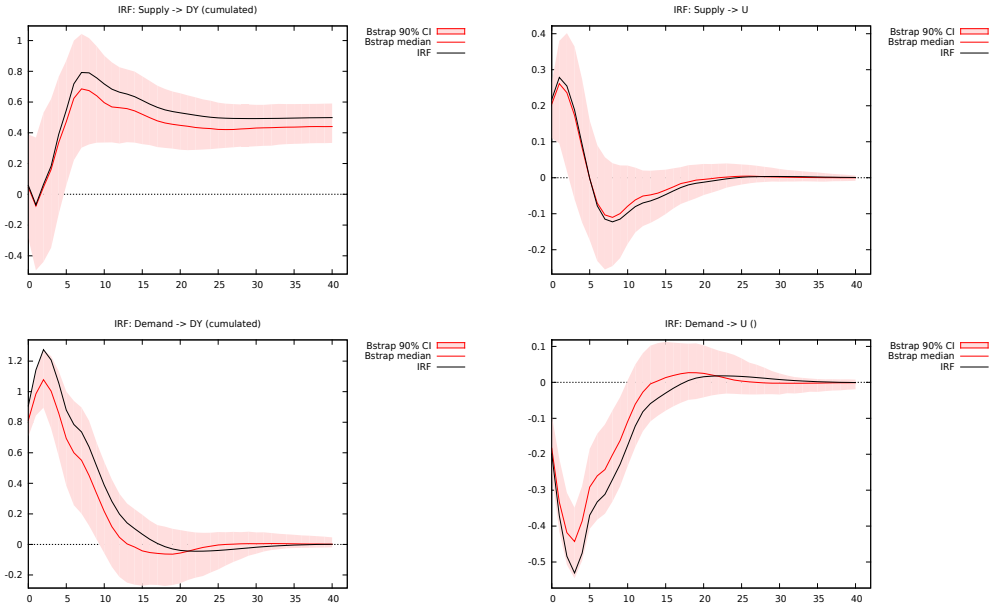


Figure 7: Impulse response functions for the Blanchard-Quah model

the shocks in the graphs. Note that in this case there is no ad-hoc function, but we rely on the standard gretl syntax for bundles.

In Table 7 I reported the output to the example code in Table 6, while the pretty pictures are in Figure 7. Note that in the two calls to `IRFplot` which are used to plot the responses to a demand shock, the number to identify the shock is not 2, but rather -2. This is a little trick the plotting functions use to flip the sign of the impulse responses, which may be necessary to ease their interpretation (since the shocks are identified only up to their sign).

3.3 Combining short- and long-run restrictions

In the previous example, it turned out that the estimated coefficient for $c_{1,1}$ was seemingly insignificant; if true, this would mean that the supply shock has no instantaneous effect on ΔY_t; in other words, the IRF of output to supply starts from 0. Leaving the economic implications aside, from a statistical viewpoint this could have suggested an alternative identification strategy or, more interestingly, to combine the two hypotheses into one.

The script presented in Table 6 is very easy to modify to this effect: in this case, we simply need to insert the line

```
SVAR_restrict(&BQModel, "C", 1, 1, 0)
```

somewhere between the `SVAR_setup` and the `SVAR_estimate` function. The rest is unchanged, and below is the output.

```
             coefficient   std. error      z       p-value
-----------------------------------------------------------
C[ 1; 1]      0.00000      0.00000        NA       NA
```

```
C[ 2; 1]    -0.230192    0.0128681    -17.89    1.45e-71 ***
C[ 1; 2]    -0.909033    0.0508165    -17.89    1.45e-71 ***
C[ 2; 2]     0.199859    0.0111725     17.89    1.45e-71 ***

Overidentification LR test = 0.642254 (1 df, pval = 0.422896)
```

Note that, since this model is over-identified, `SVAR` automatically computes a LR test of the overidentifying restrictions. Of course, all the subsequent steps (bootstrapping and IRF plotting) can be performed just like in the previous example if so desired.

4 Historical decomposition

Traditionally, analysis of the Impulse Response Functions has been the main object of interest in the applied SVAR literature, but is by no means the only one. A natural extension of the FEVD concept (see sections 1 and 2.3) is the so-called *historical decomposition* of observed time series, which can be briefly described as follows.

Consider the representation (3); clearly, if one could observe the parameters of the system (the coefficients of the $A(\cdot)$ polynomial and the matrices μ and C) plus the sequence of structural shocks u_t, it would be possible to decompose the observed path of the y_t variables into $n+1$ distinct components: first, a purely exogenous one, incorporating the term $\mu' x_t$ plus all the feedback effects given by the lag structure $A(L)$; this is commonly termed the "deterministic component" (call it d_t). The remainder $y_t - d_t$ can be therefore thought of as the superimposition of separate contributions, given by each structural shock hitting the system at a given time. In practice, we'd think of each individual series in the system as

$$y_{it} - d_{i,t} = M_{i,1}(L)u_{1,t} + \cdots + M_{i,n}(L)u_{n,t}$$

using representation (4).

In a way, historical decomposition could be considered as a particular form of counterfactual analysis: since structural shocks are assumed to be incorrelated to one another, each component $M_{i,j}(L)u_{j,t}$ shows what the history of $y_{i,t}$ would have been if the j-th shock had been the only one affecting the system.

From a technical point of view, the decomposition is computed via a "rotated" version of the system[14]: premultiplying equation (3) by C^{-1} gives

$$y_t^* = \mu^{*\prime} x_t + \sum_{i=1}^{p} A_i^* y_{t-i}^* + u_t$$

where $y_t^* \equiv C^{-1} y_t$ and $A_i^* \equiv C^{-1} A_i C$. This makes it trivial to compute the historical contributions of the structural shocks u_t to the rotated variables y_t^*, which are then transformed back into the original series y_t.

The decomposition above can be performed in the SVAR package using the estimated quantities by the `SVAR_hd` function, which takes two arguments: a pointer to the SVAR model and an integer, indicating which variable you want

[14] I know, I know: strictly speaking, it's not a rotation; for it to be a rotation, you ought to force C to be orthogonal somehow; but let's not be pedantic, ok?

```
set echo off
set messages off
include SVAR.gfn
open BlQuah.gdt

list X = DY U
list exog = const time

# set up the model
BQModel = SVAR_setup("C", X, exog, 8)

# set up the long-run restriction
SVAR_restrict(&BQModel, "lrC", 1, 2, 0)

# perform estimation
SVAR_estimate(&BQModel)

# now perform historical decomposition
list HDDY = SVAR_hd(&BQModel, 1)
list HDU  = SVAR_hd(&BQModel, 2)

# check that the observed time series can be reproduced exactly
# from the individual decomposed series
ols DY const HDDY

# cumulate the effect of the demand shock on DY
series hd_Y_2 = cum(hd_DY_2)
# reproduce Figure 8
gnuplot hd_Y_2 --time-series --with-lines --output=display

# reproduce Figure 10
gnuplot hd_U_2 --time-series --with-lines --output=display
```

Table 8: Historical decomposition for the Blanchard-Quah model

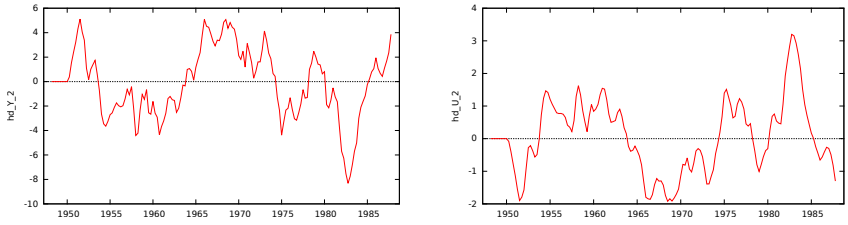
the decomposition for. Upon successful completion, it will return a list of $n+1$ series, containing the deterministic component and the n separate contributions by each structural shock to the observed trajectory of the chosen variable. The name of each variable so created will be given by the `hd_` prefix, the name of the variable, plus a number for each shock (`det` for the deterministic component).

The example given in Table 8 illustrates how to replicate figures 8 (p. 664) and 10 (p. 665) in Blanchard and Quah (1989), where the contribution of demand shocks ot output and unemployment is reconstructed. The output on your screen should be roughly similar to figure 8.

5 AB models

5.1 A simple example

AB models are more general than the C model, but more rarely used in practice. In order to exemplify the way in which they are handled in the `SVAR`



Output Unemployment

Figure 8: Effects of a demand shock in the Blanchard-Quah model

package, I will replicate the example given in section 4.7.1 of Lütkepohl and Krätzig (2004). See Table 9.

This is an empirical implementation of a standard Keynesian IS-LM model in the formulation by Pagan (1995). The vector of endogenous variables includes output q_t, interest rate i_t and real money m_t; the matrices A and B are

$$A = \begin{bmatrix} 1 & a_{12} & 0 \\ a_{21} & 1 & a_{31} \\ 0 & 0 & 1 \end{bmatrix} \qquad B = \begin{bmatrix} b_{11} & 0 & 0 \\ 0 & b_{22} & 0 \\ 0 & 0 & b_{33} \end{bmatrix}$$

so for example the first structural relationship is

$$\varepsilon_t^q = -a_{12}\varepsilon_t^i + u_t^{IS} \tag{8}$$

which can be read as an IS curve. The LM curve is the second relationship, while money supply is exogenous.

The model is set up via the function `SVAR_setup`, like in the previous section. Note, however, that in this case the model code is `"AB"` rather than `"C"`. The base VAR has 4 lags, with the constant and a linear time trend as exogenous variables. The horizon of impulse response analysis is set to 48 quarters.

The constraints on the matrices A and B can be set up quite simply by using a the function `SVAR_restrict` via a special syntax construct: the line

```
SVAR_restrict(&ISLM, "Adiag", 1)
```

sets up a system of constraints such that all elements on the diagonal of A are set to 1. More precisely, `SVAR_restrict(&Model, "Adiag", x)` sets all diagonal elements of A to the value x, unless x is `NA`. In that case, all *non-diagonal* elements are constrained to 0, while diagonal elements are left unrestricted; in other words, the syntax

```
SVAR_restrict(&ISLM, "Bdiag", NA)
```

is a compact form for saying "B is diagonal". The other three constraints are set up as usual.

Estimation is then carried out via the `SVAR_estimate` function; as an example, Figure 9 shows the effect on the interest rate of a shock on the IS curve. This example also shows how to retrieve extimated quantities from the model: after estimation, the bundle elements `"S1"` and `"S2"` contain the estimated A and B matrices; the C matrix is then computed and printed out.

The output is shown below:

```
set echo off
set messages off
include SVAR.gfn
open IS-LM.gdt

list X = q i m
list Z = const time

ISLM = SVAR_setup("AB", X, Z, 4)
ISLM["horizon"] = 48

SVAR_restrict(&ISLM, "Adiag", 1)
SVAR_restrict(&ISLM, "A", 1, 3, 0)
SVAR_restrict(&ISLM, "A", 3, 1, 0)
SVAR_restrict(&ISLM, "A", 3, 2, 0)
SVAR_restrict(&ISLM, "Bdiag", NA)
ISLM["snames"] = "uIS uLM uMS"
SVAR_estimate(&ISLM)

Amat = ISLM["S1"]
Bmat = ISLM["S2"]

printf "Estimated contemporaneous impact matrix (x100) =\n%10.6f", \
  100*inv(Amat)*Bmat

rej = SVAR_boot(&ISLM, 2000, 0.95)
IRFplot(&ISLM, 1, 2)
```

Table 9: Estimation of an AB model — example from Lütkepohl and Krätzig (2004)

```
           coefficient   std. error      z       p-value
-----------------------------------------------------------
A[ 1; 1]    1.00000       0.00000     NA        NA
A[ 2; 1]   -0.144198      0.280103    -0.5148    0.6067
A[ 3; 1]    0.00000       0.00000     NA        NA
A[ 1; 2]   -0.0397571     0.155114    -0.2563    0.7977
A[ 2; 2]    1.00000       0.00000     NA        NA
A[ 3; 2]    0.00000       0.00000     NA        NA
A[ 1; 3]    0.00000       0.00000     NA        NA
A[ 2; 3]    0.732161      0.146135     5.010     5.44e-07 ***
A[ 3; 3]    1.00000       0.00000     NA        NA

           coefficient   std. error      z      p-value
-----------------------------------------------------------
B[ 1; 1]   0.00671793    0.000473619   14.18    1.15e-45 ***
B[ 2; 1]   0.00000       0.00000       NA       NA
B[ 3; 1]   0.00000       0.00000       NA       NA
B[ 1; 2]   0.00000       0.00000       NA       NA
B[ 2; 2]   0.00858125    0.000581359   14.76    2.63e-49 ***
B[ 3; 2]   0.00000       0.00000       NA       NA
B[ 1; 3]   0.00000       0.00000       NA       NA
B[ 2; 3]   0.00000       0.00000       NA       NA
```

```
  B[ 3; 3]   0.00555741    0.000371320   14.97    1.21e-50 ***

Estimated contemporaneous impact matrix (x100) =
  0.675666  0.034313 -0.016270
  0.097430  0.863073 -0.409238
  0.000000  0.000000  0.555741

Bootstrap results (2000 replications)

            coefficient   std. error      z       p-value
  ------------------------------------------------------------
  A[ 1; 1]    1.00000       0.00000     NA        NA
  A[ 2; 1]   -0.0909784     0.395312    -0.2301    0.8180
  A[ 3; 1]    0.00000       0.00000     NA        NA
  A[ 1; 2]   -0.0377229     0.228185    -0.1653    0.8687
  A[ 2; 2]    1.00000       0.00000     NA        NA
  A[ 3; 2]    0.00000       0.00000     NA        NA
  A[ 1; 3]    0.00000       0.00000     NA        NA
  A[ 2; 3]    0.782728      0.181538     4.312     1.62e-05 ***
  A[ 3; 3]    1.00000       0.00000     NA        NA


            coefficient   std. error      z       p-value
  ------------------------------------------------------------
  B[ 1; 1]   0.00635862    0.000850539    7.476    7.66e-14 ***
  B[ 2; 1]   0.00000       0.00000       NA       NA
  B[ 3; 1]   0.00000       0.00000       NA       NA
  B[ 1; 2]   0.00000       0.00000       NA       NA
  B[ 2; 2]   0.00814276    0.00111305     7.316    2.56e-13 ***
  B[ 3; 2]   0.00000       0.00000       NA       NA
  B[ 1; 3]   0.00000       0.00000       NA       NA
  B[ 2; 3]   0.00000       0.00000       NA       NA
  B[ 3; 3]   0.00512819    0.000478826   10.71     9.14e-27 ***
```

6 Checking for identification

Connsider equation (2) again, which we reproduce here for clarity:

$$A\varepsilon_t = Bu_t$$

Since the u_t are assumed mutually incorrelated with unit variance, the following relation must hold:

$$A\Sigma A' = BB' \tag{9}$$

If $C \equiv A^{-1}B$, the relationship between prediction errors and structural shocks becomes

$$\varepsilon_t = Cu_t \tag{10}$$

and equation (9) can be written as

$$\Sigma = CC'.$$

The matrix Σ can be consistently estimated via the sample covariance matrix of VAR residuals, but estimation of A and B is impossible unless some

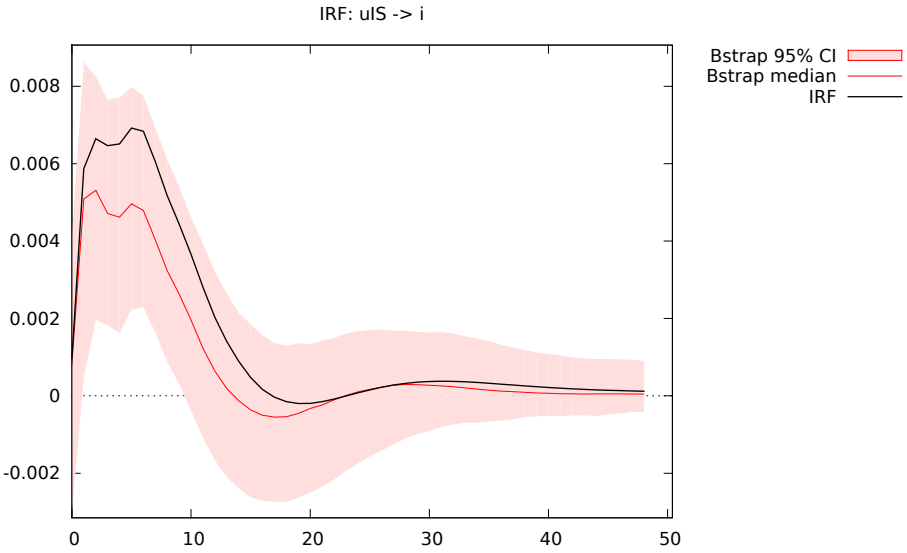


Figure 9: $u^{IS} \to i$

constraints are imposed on both matrices: $\hat{\Sigma}$ contains $\frac{n(n+1)}{2}$ distinct entries; clearly, the attempt to estimate $2n^2$ parameters violates an elementary order condition.

In general, however, one may wish to achieve identification by other means.[15] The most immediate way to place enough constraints on the A and B matrices so to achieve identification is to specify a system of linear constraints; in other words, the restrictions on A and B take the form

$$R_a \operatorname{vec} A = d_a \tag{11}$$
$$R_b \operatorname{vec} B = d_b \tag{12}$$

This setup is perhaps overly general in most cases: the restrictions that are put almost universally on A and B are zero- or one-restrictions, that is constraints of the form, eg, $A_{ij} = 1$. In these cases, the corresponding row of R is a vector with a 1 in a certain spot and zeros everywhere else. However, generality is nice for exploring the identification problem.

The order condition demands that the number of restrictions is at least $2n^2 - \frac{n(n+1)}{2} = n^2 + \frac{n(n-1)}{2}$, so for the order condition to be fulfilled it is necessary that

$$\begin{aligned} 0 < &\quad \operatorname{rank}(R_a) &&\leq n^2 \\ 0 < &\quad \operatorname{rank}(R_b) &&\leq n^2 \\ n^2 + \frac{n(n-1)}{2} \leq &\quad \operatorname{rank}(R_a) + \operatorname{rank}(R_b) &&\leq 2n^2 \end{aligned}$$

[15] Necessary and sufficient conditions to achieve identification are stated in Lucchetti (2006). Other interesting contributions in this area is Rubio-Ramirez et al. (2010) and Bacchiocchi (2011).

For the C model, $R_a = I_{n^2}$ and $d_a = \operatorname{vec} I_n$, so to satisfy the order condition $\frac{n(n-1)}{2}$ constraints are needed on on B: in practice, for a C model we have one set of constraints which pertain to B, or, equivalently in this context, to C:

$$R \operatorname{vec} C = d \tag{13}$$

The problem is that the order condition is necessary, but not sufficient. It is possible to construct models in which the order condition is satisfied but there is an uncountable infinity of solutions to the equation $A\Sigma A' = BB'$. If you try to estimate such a model, you're bound to hit all sorts of numerical problems (apart from the fact, of course, that your model will have no meaningful economic interpretation).

In order to ensure identification, another condition, called the *rank* condition, has to hold together with the order condition. The rank condition is described in Amisano and Giannini (1997) (chapter 4 for the AB model), and it involves the rank of a certain matrix, which can be computed as a function of the four matrices R_a, d_a, R_b and d_b. The `SVAR` package contains a function for doing just that, whose name is `SVAR_ident`.

As a simple example, let's check that the plain model is in fact identified by running a simple variation of the example contained in Table 3:

```
set echo off
set messages off

include SVAR.gfn
open sw_ch14.gdt

genr infl = 400*ldiff(PUNEW)
rename LHUR unemp

list X = unemp infl
list Z = const

Mod = SVAR_setup("C", X, Z, 3)
SVAR_restrict(&Mod, "C", 1, 2)

# Now check for identification
scalar is_identified = SVAR_ident(&Mod)
if is_identified
    printf "Whew!\n"
else
    printf "Blast!\n"
endif

# Re-check, verbosely
scalar is_identified = SVAR_ident(&Mod, 1)
```

The above code should produce the following output:

```
Order condition OK
Rank condition OK
Whew!
Constraints in implicit form:
```

```
Ra:
   1   0   0   0
   0   1   0   0
   0   0   1   0
   0   0   0   1

da:
   1
   0
   0
   1

Rb:
   0   0   1   0

db:
   0

no. of constraints on A: 4
no. of constraints on B: 1
no. of total constraints: 5
no. of necessary restrictions for the order condition = 5
Order condition OK
rank condition: r = 5, cols(Q) = 5
Rank condition OK
```

7 Structural VECMs

The functions for these models aren't ready for production use yet. Hopefully, they will be soon. If you're feeling brave, have a look at the `awm.inp` file in the examples directory.

This class of models was first proposed in King et al. (1991).[16] A SVECM is basically a C-model in which the interest is centred on classifying structural shocks as permanent or transitory by exploiting the presence of cointegration.

Suppose we have an n-dimensional system with cointegration rank r. Apart from the usual ECM representation

$$\Gamma(L)\Delta y_t = \alpha\beta' y_{t-1} + \varepsilon_t$$

it is also possible to express Δy_t as a vector moving average process

$$\Delta y_t = C(L)\varepsilon_t. \tag{14}$$

The main consequence of cointegration for eq. (14) is that $C(1)$ is a singular matrix. As Granger's representation theorem shows, the $C(1)$ matrix satisfies

$$\begin{aligned} \beta' C(1) &= 0 \\ C(1)\alpha &= 0; \end{aligned}$$

[16] A very nice paper in the same vein which is also frequently cited is Gonzalo and Ng (2001). A compact yet rather complete analysis of the main issues in this context can be found in Lütkepohl (2006).

thus, the rank of $C(1)$ is $n - r$.

The implications of the above on structural estimation stem from the consideration that the ij-th element of $C(1)$ can be thought of as the long-run response of $y_{i,t}$ to $\varepsilon_{j,t}$ or, more precisely

$$C(1)_{i,j} = \lim_{k\to\infty} \frac{\partial y_{i,t+k}}{\partial \varepsilon_{j,t}}.$$

The response of y_t to structural shocks is easily seen (via eq. 10) to be $C(1) \cdot C$. Now, define a transitory shock as a structural shock that has no long-run effect on any variable: hence, the corresponding column of $C(1) \cdot C$ must be full of zeros. But this, in turn, implies that the corresponding column of C must be a linear combination of the columns of α. Since α has r linearly independent columns, the vector of structural shocks must contain r transitory shocks and $n - r$ permanent ones.

By ordering the structural shocks with the permanent ones first,

$$u_t = \begin{bmatrix} u_t^p \\ u_t^t \end{bmatrix}$$

it's easy to see that identification of the transitory shocks can be achieved by imposing that the last r columns of C lie in the space spanned by α; in formulae,

$$\alpha_\perp' C J = 0, \tag{15}$$

where J is the matrix

$$J = \begin{bmatrix} 0_{n-r\times r} \\ I_{r\times r} \end{bmatrix}$$

and $\perp$ is the "nullspace" operator, that is: if M is an $r \times c$ matrix, with $r > c$ and $\text{rank}\,(M) = c$, then $M_\perp$ is some matrix[17] such that $M_\perp' M = 0$.

Equation (15) can be expressed in vector form as

$$(J' \otimes \alpha_\perp')\,\text{vec}(C) = 0;$$

since $\alpha_\perp$ has $n - r$ columns, this provides $r \cdot (n - r)$ constraints of the type $R\,\text{vec}(C) = d$, that we know how to handle. Since $0 < r < n$, this system of constraints is not sufficient to achieve identification, apart from the special case $n = 2, r = 1$.

For this type of models, the keyword to use in the `SVAR_setup` function is `KPSW`.

The matrix β is not estimated within `SVAR` and must be supplied by the user and put into the `jbeta` element of the model bundle. This allows you to estimated the cointegration vectors by any method you like (or pre-set them to some theory-derived value). Note that the `$jbeta` standard gretl accessor makes it painless to fetch it from a Johansen-style VECM if necessary.

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[17] Note: $M_\perp$ is not unique.

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A Alphabetical list of functions

`FEVD(bundle *SVARobj)`

Computes the Forecast Error Variance Decomposition from the structural IRFs, as contained in the model `SVARobj`. Returns an $h \times n^2$ matrix. The FEVD for variable k is the block of columns from $(k-1)n+1$ to kn (where n is the number of variables in the VAR).

`FEVDplot(bundle *obj, scalar vnum)`

Plots on screen the Forecast Error Variance Decomposition for a variable. Its arguments are:

1. a bundle holding the model
2. the progressive number of the variable

`FEVDsave(string outfilename, bundle *obj, scalar vnum)`

Saves the Forecast Error Variance Decomposition for a variable to a graphic file, whose format is identified by its extension. Its arguments are:

1. The graphic file name
2. a bundle holding the model
3. the progressive number of the variable

`GetShock(bundle *SVARobj, scalar i)`

Retrieves, as a series, the estimate of i-th structural shock of the system via equation (2), in which VAR residuals are used instead of the one-step-ahead prediction errors ε_t. If the bundle `SVARobj` contains a non-null string `snames` with shock names, those are used in the description for the generated series.

`IRFplot(bundle *obj, scalar snum, scalar vnum)`

Plots an impulse response function on screen. Its arguments are:

1. a bundle holding the model
2. the progressive number of the shock (may be negative, in which case the IRF is flipped)

3. the progressive number of the variable

`IRFsave(string outfilename, bundle *obj, scalar snum, scalar vnum)`

Saves an impulse response function to a graphic file, whose format is identified by its extension. Its arguments are:

1. The graphic file name
2. a bundle holding the model
3. the progressive number of the shock (may be negative, in which case the IRF is flipped)
4. the progressive number of the variable

`SVAR_boot(bundle *obj, scalar rep, scalar alpha)`

Perform a bootstrap analysis of a model. Returns the number of bootstrap replications in which the model failed to converge. Its arguments are:

1. a bundle holding the model
2. the number of bootstrap replications
3. the quantile used for the confidence bands

`SVAR_cumulate(bundle *b, scalar nv)`

Stores into the model the fact that the cumulated IRFs for variable `nv` are desired. This is typically used jointly with long-run restrictions.

`SVAR_estimate(bundle *obj, int quiet)`

Estimates the model by maximum likelihood. Its second argument is a scalar, which controls the verbosity of output. If omitted, estimation proceeds silently.

`SVAR_hd(bundle *b, scalar nv)`

Performs the "historical decomposition" of variable `nv`: this function outputs a list of variables which decomposes the `nv`-th variable in the system into a deterministic component and n stochastic components. The names of the resulting series are as follows: if the name of the decomposed variable is `foo`, then the historical component attributable to the first structural shock is called `hd_foo_1`,

the one attributable to the second structural shock is called `hd_foo_2`, and so on. Finally, the one for the first deterministic component is called `hd_foo_det`.

`SVAR_ident(bundle *b, int verbose[0])`

Checks if a model is identified by applying the algorithm described in Amisano and Giannini (1997). Returns a 0/1 scalar. Its second argument is a scalar, which controls the verbosity of output. If set to a non-zero value, a few messages are printed as checks are performed.

`SVAR_restrict(bundle *b, string code, scalar r, scalar c, scalar d)`

Sets up contraints for an existing model. The function which takes at most five arguments:

1. A pointer to the model for which we want to set up the restriction(s)
2. A code for which type of restriction we want:

   `"C"` Applicable to C models. Used for short-run restrictions.

   `"lrC"` Applicable to C models. Used for long-run restrictions.

   `"A"` Applicable to AB models. Used for constraints on the A matrix.

   `"B"` Applicable to AB models. Used for constraints on the B matrix.

   `"Adiag"` Applicable to AB models. Used for constraints on the whole diagonal of the A matrix (see below).

   `"Bdiag"` Applicable to AB models. Used for constraints on the whole diagonal of the B matrix (see below).

3. An integer:

   case 1 : applies to the codes `"C"`, `"lrC"`, `"A"` and `"B"`. Indicates the row of the restricted element.

   case 2 : applies to the codes `"Adiag"` and `"Bdiag"`. Indicates what kind of restriction is to be placed on the diagonal: any valid scalar indicates that the diagonal of A (or B) is set to that value. Almost invariably, this is used with the value 1. IMPORTANT: if this argument is `NA`, all *non-diagonal* elements are constrained to 0, while diagonal elements are left unrestricted.

4. An integer: the column of the restricted element, for the codes `"C"`, `"lrC"`, `"A"` and `"B"`. Otherwise, unused.
5. A scalar: for the codes `"C"`, `"lrC"`, `"A"` and `"B"`, the fixed value the matrix element should be set to (may be omitted if 0). Otherwise, unused.

A few examples:

- `SVAR_restrict(&M, "C", 3, 2, 0)`; in a C model called `M`, sets $C_{3,2} = 0$. As a consequence, the IRF for variable number 3 with respect to the shock number 2 starts from zero.

- `SVAR_restrict(&foo, "A", 1, 2, 0)`; in an AB model called `foo`, sets $A_{1,2} = 0$.
- `SVAR_restrict(&MyMod, "lrC", 5, 3, 0)`; in a C model called `MyMod`, restricts C such that the long-run impact of shock number 3 on variable number 5 is 0. This implies that the cumulated IRF for variable 5 with respect to shock 3 tends to zero.
- `SVAR_restrict(&bar, "Adiag", 1)`; in an AB model called `bar`, sets $A_{i,i} = 1$ for $1 \leq i \leq n$.
- `SVAR_restrict(&baz, "Bdiag", NA)`; in an AB model called `baz`, sets $B_{i,j} = 0$ for $i \neq j$.

If the restrictions are found to conflict with other ones already implied by the pre-existing constraints, they will just be ignored and a warning will be printed.

`SVAR_setup(string type, list Y, list X, int varorder)`

Initialises a model: the function's output is a bundle. The function arguments are:

1. A type string: at the moment, valid values are `"C"`, `"plain"` and `"AB"`;
2. a list containing the endogenous variables;
3. a list containing the exogenous variables;
4. a positive integer, the VAR order.

B Contents of the model bundle

	Basic setup
`step`	done so far
`type`	string, model type
`n`	number of endogenous variables
`p`	VAR order
`k`	number of exogenous variables
`T`	number of observations
`X`	exogenous variables data matrix
	VAR
`VARpar`	autoregressive parameters
`mu`	coefficients for the deterministic terms
`E`	residuals from base VAR (as matrix)
`Sigma`	unrestricted covariance matrix
`jalpha`	(SVECM only) cointegration loadings
`jbeta`	(SVECM only) cointegration coefficients
	SVAR setup
`Rd1`	main matrix of constraints
`aux`	depends
`nc1`	number of constraints in `Rd1`
`nc2`	number of constraints in `aux`
`horizon`	horizon for structural VMA
`cumul`	vector of cumuland variables
`ncumul`	number of cumuland variables
`snames`	string, Names for shocks (may be empty)
`optmeth`	integer between 0 and 4, optimisation method
	SVAR post-estimation
`S1`	estimated A (or C)
`S2`	estimated B
`theta`	coefficient vector
`IRFs`	IRF matrix (see section 2.1.2)
	Bootstrap-related
`nboot`	number of bootstrap replications
`boot_alpha`	bootstrap confidence level
`bootdata`	output from the bootstrap (see section 2.4)
`biascorr`	scalar, 0 for no bias correction