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THE ANALYSIS OF THE EFFECTS OF FISCAL POLICY ON BUSINESS CYCLE - A SVAR APPLICATION

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Abstract

This paper presents theoretic concepts of VAR models and several ways of their identification. We proceed by estimating a VAR model for budget deficit, real interest rate, GDP growth rate and GDP deflator on data for the Slovak republic for the period 1997 – 2007. We identify this reduced form by a combination of the approach of Blanchard and Perotti and sign restrictions approach by Canova and de Nicoló. The results for the fiscal shock lean towards the predictions of neoclassical theory: an increase of the ratio of budget deficit to GDP by one percent permanently causes an immediate rise in the GDP growth by just 0.4 percent that weakens to 0.2 percent in further quarters and dies out completely after six quarters. But the increase in deficit leads also to a permanent increase in real interest rate. However, the reliability of the results may be reduced by small number of observations and qualitative changes in the sample period.

Key words: VAR model, structural shock, sign restrictions, fiscal shock
JEL classification: E62, H62

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