Abstract

In this paper we estimate a small forward-looking macroeconomic model for EMU which allows us to analyze the transmission mechanism of the monetary policy implemented by the European Central Bank through an interest rate rule that stabilizes inflation and output. The estimation of this model, which comprises forward-looking versions of the IS and the Phillips curves as well as the interest rate rule, is conducted by GMM using quarterly data from 1986 to 2000. We find that this simple model matches the dynamic properties of the output gap, inflation and the interest rate in EMU quite accurately. We also perform several exercises that show the response of output, inflation and interest rates to different kinds of shocks affecting the economy, under the assumption that the ECB implements the monetary policy described by the estimated interest rate rule. Comparisons with backward-looking models for the United States show that our forward-looking model produces less persistence of the endogenous variables in response to shocks of the same magnitude.

Keywords: IS curve, inflation, interest rate rule, monetary policy

JEL Classification: E31, E32, E52