Contents

Figures xi

Tables xiii

Series Editors' Introduction xv

Preface xvii

I Introduction to DSGE Modeling and Bayesian Inference 1

1 DSGE Modeling 3
- 1.1 A Small-Scale New Keynesian DSGE Model 4
- 1.2 Other DSGE Models Considered in This Book 11

2 Turning a DSGE Model into a Bayesian Model 14
- 2.1 Solving a (Linearized) DSGE Model 16
- 2.2 The Likelihood Function 19
- 2.3 Priors 22

3 A Crash Course in Bayesian Inference 29
- 3.1 The Posterior of a Linear Gaussian Model 31
- 3.2 Bayesian Inference and Decision Making 35
- 3.3 A Non-Gaussian Posterior 43
- 3.4 Importance Sampling 46
- 3.5 Metropolis-Hastings Algorithms 52

II Estimation of Linearized DSGE Models 63

4 Metropolis-Hastings Algorithms for DSGE Models 65
4.1 A Benchmark Algorithm 67
4.2 The RWMH-V Algorithm at Work 69
4.3 Challenges Due to Irregular Posteriors 77
4.4 Alternative MH Samplers 81
4.5 Comparing the Accuracy of MH Algorithms 87
4.6 Evaluation of the Marginal Data Density 93

5 Sequential Monte Carlo Methods 100
5.1 A Generic SMC Algorithm 101
5.2 Further Details of the SMC Algorithm 109
5.3 SMC for the Small-Scale DSGE Model 125

6 Three Applications 130
6.1 A Model with Correlated Shocks 131
6.2 The Smets-Wouters Model with a Diffuse Prior 141
6.3 The Leeper-Plante-Traum Fiscal Policy Model 150

III Estimation of Nonlinear DSGE Models 161

7 From Linear to Nonlinear DSGE Models 163
7.1 Nonlinear DSGE Model Solutions 164
7.2 Adding Nonlinear Features to DSGE Models 167

8 Particle Filters 171
8.1 The Bootstrap Particle Filter 173
8.2 A Generic Particle Filter 182
8.3 Adapting the Generic Filter 185
8.4 Additional Implementation Issues 191
8.5 Adapting s_{t-1} Draws 198
8.6 Application to the Small-Scale DSGE Model 204
8.7 Application to the SW Model 212
8.8 Computational Considerations 216

9 Combining Particle Filters with MH Samplers 218
9.1 The PFMH Algorithm 218
9.2 Application to the Small-Scale DSGE Model 222
9.3 Application to the SW Model 224

9.4 Computational Considerations 229

10 Combining Particle Filters with SMC Samplers 231
10.1 An SMC^2 Algorithm 231
10.2 Application to the Small-Scale DSGE Model 237
10.3 Computational Considerations 239

Appendix 241

A Model Descriptions 241
A.1 Smets-Wouters Model 241
A.2 Leeper-Plante-Traum Fiscal Policy Model 247

B Data Sources 249
B.1 Small-Scale New Keynesian DSGE Model 249
B.2 Smets-Wouters Model 249
B.3 Leeper-Plante-Traum Fiscal Policy Model 251

Bibliography 257

Index 271