Online Appendix

Testing the effectiveness of unconventional monetary policy in Japan and the United States

Daisuke Ikeda∗
Bank of Japan

Shangshang Li†
University of Oxford

Sophocles Mavroeidis ‡
University of Oxford and INET

Francesco Zanetti §
University of Oxford

May 2023

A Theoretical Model

Appendix A presents a simple New Keynesian model with an effective lower bound (ELB) and unconventional monetary policy (UMP). The model is a version of a preferred habitat model such as Chen et al. (2012), extended to incorporate two things: a policy rule for quantitative easing (QE) that is operated using a shadow rate as policy guidance and forward guidance (FG) in the spirit of Reifschneider and Williams (2000). To keep the analysis focused on the salient features of the transmission mechanisms of UMP, the model abstracts from capital accumulation and consumption habit formation. There are three shocks: a demand (preference) shock, a supply (productivity) shock, and a monetary policy shock.

A.1 Model building blocks

A.1.1 Long-term bonds

There is a long-term government bond (consol bond). The long-term bond issued at time \( t \) yields \( \mu^{j-1} \) dollars at time \( t + j \) over time. Let \( R_{L,t+1} \) denote the gross nominal rate from time \( t \) to \( t + 1 \). The period-\( t \) price of the bond issued at time \( t \), \( P_{L,t} \), is defined as

\[
P_{L,t} = E_t \left( \frac{1}{R_{L,t+1}} + \frac{\mu}{R_{L,t+1} R_{L,t+2}} + \frac{\mu^2}{R_{L,t+1} R_{L,t+2} R_{L,t+3}} + \ldots \right) \\
= E_t \left( \frac{1}{R_{L,t+1}} + \frac{\mu}{R_{L,t+1}} P_{L,t+1} \right). \tag{A.1}
\]

∗Bank of Japan, daisuke.ikeda@boj.or.jp.
†University of Oxford, Department of Economics: shangshang.li@economics.ox.ac.uk
‡University of Oxford, Department of Economics: sophocles.mavroeidis@economics.ox.ac.uk.
§University of Oxford, Department of Economics: francesco.zanetti@economics.ox.ac.uk.
The gross yield to maturity (or the long-term interest rate) at time $t$, $\bar{R}_{L,t}$ is defined as

$$E_t \left( \frac{1}{R_{L,t}} + \frac{\mu}{(R_{L,t})^2} + \frac{\mu^2}{(R_{L,t})^3} + \ldots \right) = P_{L,t},$$

or

$$P_{L,t} = \frac{1}{R_{L,t} - \mu}. \quad (A.2)$$

Let $B_{L,t|t-s}$ denote period-$t$ holdings of bonds that were issued at time $t - s$. Suppose that a household has $B_{L,t|t-s}$ for $s = 1, 2, \ldots$ in the beginning of period $t$. The total amount of dividends the household receives in period $t$ is

$$\sum_{s=1}^{\infty} \mu^{s-1} B_{L,t|t-s}.$$ 

Note that having one unit of $B_{L,t|t-s}$ is equivalent to having $\mu^{s-1}$ units of $B_{L,t|t-1}$ because they both yield $\mu^{s-1}$ dollars. The total amount of dividends then can be expressed in terms of $B_{L,t|t-1}$ as

$$\sum_{s=1}^{\infty} \mu^{s-1} B_{L,t|t-s} \equiv B_{L,t-1},$$

where $B_{L,t-1}$ denotes the amount of bonds in units of the bonds issued at time $t - 1$, held by the household in the beginning of period $t$. Let $P_{L,t|t-s}$ denote the time-$t$ price of the bond issued at time $t - s$. Then, the value of all bonds at time $t$ is

$$\sum_{s=1}^{\infty} P_{L,t|t-s} B_{L,t|t-s}.$$ 

The bond price satisfies

$$P_{L,t|t-s} = E_t \left( \frac{\mu^s}{R_{L,t+1}} + \frac{\mu^{s+1}}{R_{L,t+1}R_{L,t+2}} + \frac{\mu^{s+2}}{R_{L,t+1}R_{L,t+2}R_{L,t+3}} + \ldots \right) = \mu^s P_{L,t}$$

Then the value of all bonds at time $t$ is

$$\sum_{s=1}^{\infty} P_{L,t|t-s} B_{L,t|t-s} = P_{L,t} \sum_{s=1}^{\infty} \mu^{s-1} B_{L,t|t-s} = \mu P_{L,t} B_{L,t-1}.$$ 

So the return of holding $B_{L,t-1}$ is given by the sum of dividends and the value of all bonds as:

$$B_{L,t-1} + \mu P_{L,t} B_{L,t-1} = (1 + \mu P_{L,t}) B_{L,t-1} = P_{L,t} \bar{R}_{L,t} B_{L,t-1} = \frac{R_{L,t}}{R_{L,t} - \mu} B_{L,t-1}.$$
A.1.2 Households

There are two types of households: unrestricted households (U-households) and restricted households (R-households). U-households, with population \( \omega_u \), can trade both short-term and long-term government bonds subject to a transaction cost \( \zeta_t \) per unit of long-term bonds purchased. R-households, with population \( \omega_r = 1 - \omega_u \), can trade only long-term government bonds. For \( j = u, r \), each household chooses consumption \( c_j^t \), hours worked \( h_j^t \), the long-term government bond holdings \( B_{L,t}^j \), and the short-term government bond holdings \( B_{S,t}^j \) to maximize utility,

\[
\sum_{t=0}^{\infty} \beta^t d_t \left[ \frac{(c_i^t)^{1-\sigma}}{1-\sigma} - \psi \frac{(h_i^t)^{1+\nu}}{1+\nu} \right],
\]

subject to: for a U-household,

\[
P_t c^u_t + B_{S,t}^u + (1 + \zeta_t) P_{L,t} B_{L,t}^u = (1 + i_{t-1}) B_{L,t-1}^u + P_{L,t} \bar{R}_{L,t} B_{L,t-1}^u + W_t h^u_t - T^u_t + \Pi^u_t,
\]

and for a R-household,

\[
P_t c^r_t + P_{L,t} B_{L,t}^r = P_{L,t} \bar{R}_{L,t} B_{L,t-1}^r + W_t h^r_t - T^r_t + \Pi^r_t,
\]

where \( P_t \) is the price level and \( i_t \) is the short-term interest rate. In addition \( \bar{R}_{L,t} \) denotes the gross yield to maturity at time \( t \) on the long-term bond

\[
\bar{R}_{L,t} = \frac{1}{P_{L,t}} + \mu, \quad 0 < \mu \leq 1.
\]

The average duration of the bond is given by \( \bar{R}_{L,t}/(\bar{R}_{L,t} - \mu) \). There is a shock \( d_t \) to the preference, and it is given by:

\[
d_t = \begin{cases} 
  e^{z^b_t} \ldots e^{z^b_t} & \text{for } t \geq 1 \\
  1 & \text{for } t = 0
\end{cases},
\]

where \( z^b_t \) is a preference (demand) shock, which is assumed to follow an AR(1) process

\[
z^b_t = \rho_b z^b_{t-1} + \epsilon^b_t,
\]

with \( \epsilon^b_t \sim \text{i.i.d. } N(0, \sigma^b_2) \).

We assume that the transaction cost of trading long-term bonds for the U-households is collected by financial firms and redistributed as a lump-sum profits to the U-households. Under the assumption, the transaction cost does not appear in the goods market clearing condition, which is given by:

\[
y_t = \omega_u c^u_t + (1 - \omega_u) c^r_t.
\]

Arranging the first-order conditions of the U-household’s problem yields the following optimality conditions:

\[
w_t = \psi \frac{(c^u_t)^{1-\sigma}}{1-\sigma},
\]

\[
1 = E_t \beta_u e^{\epsilon^b_{t+1}} \left( \frac{c^u_{t+1}}{c^u_t} \right)^{1+\nu},
\]

\[
1 + \zeta_t = E_t \beta_u e^{\epsilon^b_{t+1}} \left( \frac{c^u_{t+1}}{c^u_t} \right)^{-\sigma} \bar{R}_{L,t+1},
\]
where \( w_t \equiv W_t / P_t \) denotes the real wage, \( \pi_t \equiv P_t / P_{t-1} \) denotes the inflation rate, and \( R_{L,t+1} \) denotes the yield of the long-term bond between periods \( t \) and \( t+1 \), given by

\[
R_{L,t+1} = \frac{P_{L,t+1}}{P_{L,t}} = \frac{1}{P_{L,t+1}} + \mu = 1 + \mu P_{L,t+1}.
\]

Similarly, arranging the first-order conditions of the R-household’s problem yields

\[
w_t = \psi (c_t^r)^{\sigma} (h_t^r)^{1/\nu}, \quad (A.7)
\]

\[
1 = E_t \beta e^{z_{t+1}} (c_t^r/c_t^p)^{-\sigma} R_{L,t+1}^{1/\pi_t+1}. \quad (A.8)
\]

### A.1.3 Firms

The firm sector consists of two types of firms: final-goods-producing firms and intermediate-goods-producing firms. The problems of these firms are standard except that the average discount rate between U-households and R-households is used in discounting the profits of these firms. The profits need to be derived explicitly because one of the two households’ budget constraints constitutes an equilibrium condition as well as the goods market clearing condition.

Each final-goods-producing firm produces a unit of final goods \( y_t \) in a competitive market by combining intermediate goods \( \{y_t(l)\}_{l=0}^1 \) according to

\[
y_t = \left[ \int_0^1 y_t(l)^{1/\theta} dl \right]^{\lambda_p}, \quad \lambda_p > 1.
\]

The demand function for the \( l \)-th intermediate good is given by

\[
y_t(l) = \left( \frac{P_t(l)}{P_t} \right)^{\lambda_p} y_t.
\]

Each intermediate-goods-producing firm uses labor and produce intermediate goods according to

\[
y_t(l) = e^{z_t^a} h_t(l)^{\theta}, \quad 0 < \theta \leq 1.
\]

where \( z_t^a \) is a productivity shock, which is assumed to follow

\[
z_t^a = \rho_z z_{t-1}^a + \epsilon_t^a,
\]

with \( \epsilon_t^a \sim \text{i.i.d. } N(0, \sigma_a^2) \). Because there is no price dispersion in steady state, the aggregate output can be expressed up to the first-order approximation as:

\[
y_t = z_t^a + \theta h_t, \quad (A.9)
\]

where \( \hat{y}_t \) and \( \hat{h}_t \) denote the aggregate output and hours worked in terms of deviation from the steady state. The total cost of producing \( y_t(l) \) is equal to

\[
W_t h_t(l) = W_t \left( \frac{y_t(l)}{e^{z_t^a}} \right)^{1/\theta}.
\]
In each period, intermediate-goods-producing firms can change their price with probability $\xi$ identically and independently across firms and over time. For each $l$, the $l$-th intermediate-goods producing firm chooses the price, $\tilde{P}_t(l)$, to maximize the discounted sum of profits,

$$
\max_{\tilde{P}_t(l)} E_t \sum_{s=0}^{\infty} (\xi \delta)^s \tilde{\Lambda}_{t+s|t} \left[ P_{t+s} (l) y_{t+s} (l) - W_{t+s} \left( \frac{y_{t+s} (l)}{e^{\epsilon_{t+s}}} \right)^{\frac{1}{\gamma}} \right],
$$

subject to the demand curve,

$$
y_{t+s} (l) = \left( \frac{P_{t+s} (l)}{P_{t+s}} \right)^{\lambda_p} k_{t+s} y_{t+s},
$$

where

$$
\delta = \omega_u \beta_u + (1 - \omega_u) \beta_r,
$$

$$
\tilde{\Lambda}_{t+s|t} \equiv d_{t+s|t} (\omega_u \Lambda^u_{t+s|t} + (1 - \omega_u) \Lambda^r_{t+s|t}),
$$

$$
\Lambda^j_{t+s|t} = \left( \frac{c^j_{t+s}}{c^j_t} \right)^{-\sigma} \frac{1}{P_{t+s}}, \quad d_{t+s|t} = \begin{cases} 1 & \text{if } s = 0 \\ \left( e^{\epsilon_{t+1}} e^{\epsilon_{t+2}} \cdots e^{\epsilon_{t+s}} \right) & \text{if } s = 1, 2, \ldots
\end{cases}
$$

$$
P_{t+s} (l) = \tilde{P}_t(l) \Pi^p_{t,t+s|t},
$$

$$
\Pi^p_{t,s|t} = \begin{cases} 1 & \text{if } s = 0 \\ \prod_{k=1}^{s} (\pi_{t+k-1})^{\epsilon_{t+k-1}} (\pi_{t+k})^{1-\epsilon_{t+k}} & \text{if } s = 1, 2, \ldots
\end{cases}
$$

The presence of $\Pi^p_{t+s|t}$ implies price indexation for firms that do not have a chance to change prices and $0 \leq \epsilon_p \leq 1$ governs the degree of indexation to the past inflation rates. Substituting the demand curve into the objective function yields

$$
\max_{\tilde{P}_t(l)} E_t \sum_{s=0}^{\infty} (\xi \delta)^s \tilde{\Lambda}_{t+s|t} \left[ \tilde{P}_t(l) \Pi^p_{t+s|t} \left( \frac{\tilde{P}_t(l) \Pi^p_{t+s|t}}{P_{t+s}} \right)^{\lambda_p} Y_{t+s} - W_{t+s} \left( \frac{\tilde{P}_t(l) \Pi^p_{t+s|t}}{P_{t+s}} \right)^{\lambda_p} \left( \frac{y_{t+s} (l)}{e^{\epsilon_{t+s}}} \right)^{\frac{1}{\gamma}} \right].
$$

The first-order condition is

$$
0 = E_t \sum_{s=0}^{\infty} (\xi \delta)^s \tilde{\Lambda}_{t+s|t} \left[ \frac{1}{1 - \lambda_p} \Pi^p_{t+s|t} y_{t+s} (l) - W_{t+s} \frac{\lambda_p}{(1 - \lambda_p)} \theta \left( \frac{y_{t+s} (l)}{e^{\epsilon_{t+s}}} \right)^{\frac{1}{\gamma}} \frac{1}{P_t} \right].
$$

Since $\tilde{P}_t(l)$ does not depend on $l$, index $l$ is omitted hereafter. Define $\bar{p}_t \equiv \tilde{P}_t / P_t$ and

$$
\bar{\Pi}^p_{t+s|t} = \begin{cases} 1 & \text{if } s = 0 \\ \prod_{k=1}^{s} \frac{(\pi_{t+k-1})^{\epsilon_{t+k-1}} (\pi_{t+k})^{1-\epsilon_{t+k}}}{\pi_{t+k}} & \text{if } s = 1, 2, \ldots
\end{cases}
$$

The first-order condition can be transformed as

$$
0 = E_t \sum_{s=0}^{\infty} (\xi \delta)^s \tilde{\Lambda}_{t+s} P_{t+s+1} + \frac{1}{1 - \lambda_p} \bar{p}_t \bar{\Pi}^p_{t+s|t} \left( \frac{\bar{p}_t \bar{\Pi}^p_{t+s|t}}{P_{t+s}} \right)^{\lambda_p} \frac{y_{t+s} (l)}{e^{\epsilon_{t+s}}} \frac{1}{P_t}
$$

$$
- \frac{W_{t+s}}{P_{t+s}} \frac{\lambda_p}{(1 - \lambda_p)} \theta \left( \bar{p}_t \bar{\Pi}^p_{t+s|t} \right)^{\lambda_p} \left( \frac{y_{t+s} (l)}{e^{\epsilon_{t+s}}} \right)^{\frac{1}{\gamma}} \frac{1}{P_t},
$$

5
This equation can be written as:

\[
\tilde{p}_t = \left( \frac{\lambda_p}{\theta} \omega_u K_{p,t}^r + (1 - \omega_u) K_{p,t}^r \right) \frac{(1 - \lambda_p)^\theta}{\theta - \lambda_p}, \tag{A.10}
\]

where for \( j \in \{r, u\} \)

\[
F^j_{p,t} = (c^j_t)^{-\sigma} y_t + \xi \delta E_t e^{z_t+1} (\hat{\Pi}_{p,t+1}^p)^{\frac{1}{1-\lambda_p}} F^j_{p,t+1}, \tag{A.11}
\]

\[
K^j_{p,t} = (c^j_t)^{-\sigma} \left( \frac{y_t}{e^{z_t}} \right)^{\frac{1}{\theta}} w_t + \xi \delta E_t e^{z_t+1} (\hat{\Pi}_{p,t+1}^p)^{\frac{1}{1-\lambda_p}} K^j_{p,t+1}. \tag{A.12}
\]

The aggregate price level evolves following

\[
P_t = \left[ \xi \left( \pi_{t-1} \right)^{1-p} \left( \pi_{t-1} \right)^{1-\lambda_p} + (1 - \xi) \hat{P}_{t}^{1-\lambda_p} \right]^{1-\lambda_p},
\]

which can be written as

\[
\tilde{p}_t = \left[ \frac{1 - \xi (\hat{\Pi}_{p,t-1}^p)^{1-\lambda_p}}{1 - \xi} \right]^{\lambda_p}. \tag{A.13}
\]

The conditions, (A.10)-(A.13), summarize the price setting behavior of intermediate-goods-producing firms.

The aggregate nominal profits earned by intermediate-goods-producing firms are given by:

\[
\Pi^m_t = \int_0^1 \left( P_t (l) y_t (l) - W_t \left( \frac{y_t}{e^{z_t}} \right)^{\frac{1}{\theta}} \right) dl = P_t y_t - W_t \left( \frac{y_t}{e^{z_t}} \right)^{\frac{1}{\theta}},
\]

where the last equality holds up to the first-order approximation. Then, the aggregate real profits are given by \( \pi^m_t = y_t - w_t \left( \frac{y_t}{e^{z_t}} \right)^{1/\theta} \).

### A.1.4 Government

The government flow budget constraint is

\[
(1 + i_{t-1}) B_{S,t-1} + (1 + \mu P_{L,t}) B_{L,t-1} = B_{S,t} + P_{L,t} B_{L,t} + T_t,
\]

where \( T_t = \omega_u T^u_t + (1 - \omega_u) T^r_t \). We assume that the lump-sum tax is imposed on households equally so that \( T^u_t = T^r_t = T_t \). To focus on the role of long-term government bonds, we assume that the amount of short-term bonds is constant at \( b_{S,t} \equiv B_{S,t}/P_t = \bar{b}_S \).

### A.1.5 Central bank

The nominal interest rate \( i_t \) set by the central bank is bounded below by the ELB as

\[
i_t = \max \{ i^*_t, \bar{i} \}, \tag{A.14}
\]
where $\hat{i}$ is the ELB and $i^*_t$ is a shadow rate – the short-term rate the central bank would set if there were no ELB. The shadow rate $i^*_t$ is given by

$$i^*_t = \hat{i}^\text{Taylor} - \alpha \left( i_t - \hat{i}^\text{Taylor} \right). \quad \text{(A.15)}$$

The shadow rate $i^*_t$ consists of two parts: $\hat{i}^\text{Taylor}$ and $\alpha (i_t - \hat{i}^\text{Taylor})$. First, $\hat{i}^\text{Taylor}$ is the Taylor-rule-based rate that responds to inflation $\pi_t$, output $y_t$, and the lagged ‘effective’ interest rate $(1 - \lambda^*)i_{t-1} + \lambda^* i^*_{t-1}$:

$$\hat{i}^\text{Taylor} - i = \rho_i \left( (1 - \lambda^*)i_{t-1} + \lambda^* i^*_{t-1} - i \right) + (1 - \rho_i) \left[ r_\pi \log (\pi_t / \pi) + r_y \log (y_t / y) \right] + \epsilon_t^i, \quad \text{(A.16)}$$

where $\epsilon_t^i$ is a monetary policy shock and variables without subscripts denote those in steady state. The parameter $\lambda^*$ will be derived later in this appendix. Second, $\alpha (i_t - \hat{i}^\text{Taylor})$ in equation (A.15) encapsulates the strength of FG. A positive value for $\alpha$ will maintain the target rate $i^*_t$ below the Taylor rate $\hat{i}^\text{Taylor}$. Under the ELB of $i_t = \hat{i}$, the more the central bank has missed to set the interest rate at its Taylor rate, the lower the central bank sets its target rate $i^*_t$ through equation (A.15) as long as $\rho_i \lambda^* > 0$ in equation (A.16).²

The central bank activates QE when the economy hits the ELB. The central bank continues using the shadow rate as policy guidance in an ELB regime as in a non-ELB regime. Specifically, the amount of long-term bond purchases depends on the shadow rate, and as a result the amount of long-term government bonds, $b_{L,t} \equiv B_{L,t} / P_t$, held by the private agents is given by:

$$\hat{b}_{L,t} = \begin{cases} 0 & \text{if } i^*_t \geq \hat{i} \\ \gamma \frac{i^*_t - \hat{i}}{1 + \hat{i}} & \text{if } i^*_t < \hat{i} \end{cases}, \quad \text{(A.17)}$$

where the caret on a variable denotes a deviation from the steady state. This QE rule implies that asset purchases by the central bank is zero (relative to the steady state) when the ELB is not binding (i.e. $i_t = i^*_t \geq \hat{i}$) and, given $\gamma > 0$, the purchases are positive (i.e., $\hat{b}_{L,t} < 0$) when the shadow rate goes below the ELB (i.e., $i^*_t < \hat{i}$).

### A.1.6 Market clearing and equilibrium

As well as the goods market clearing condition (A.3), there are market clearing conditions for labor, long-term government bonds, and short-term government bonds:

$$\omega_u h^u_t + (1 - \omega_u) h^r_t = \bar{h}_t, \quad \text{(A.18)}$$

$$\omega_u b^u_{L,t} + (1 - \omega_u) b^r_{L,t} = b_{L,t}, \quad \text{(A.19)}$$

$$\omega_u b^u_{S,t} = b_{S,t}. \quad \text{(A.20)}$$

Also, either the U-household’s budget constraint or the R-household’s budget constraint should be added as an equilibrium condition. Here the latter budget constraint is added:

$$c^*_t + P_{L,t} b^*_{L,t} = \left( \bar{R}_{L,t} / \pi_t \right) P_{L,t} b^*_{L,t-1} + \omega_u h^*_t - T^r_t / P_t + \Pi^r_t / P_t. \quad \text{(A.21)}$$

²Debortoli et al. (2019) consider the case of $\alpha = 0$ and $\lambda^* = 1$ in equation (A.16) and interpret $\rho_i$ – the coefficient of interest rate smoothing – as FG when $i^*_t$ is below the ELB.
where
\[
\frac{T_t^r}{P_t} = - (b_{S,t} + P_{L,t}b_{L,t}) + \frac{1 + \mu P_{L,t}}{\pi_t} b_{S,t-1} + \frac{1 + \mu P_{L,t}}{\pi_t} b_{L,t-1},
\]
\[
\Pi_t^r = y_t - w_t h_t.
\]

The cost of trading long-term bonds, \(\zeta_t\), is specified as
\[
\frac{\zeta_t}{\zeta} = \left( \frac{b_{L,t}}{b_L} \right)^{\rho_\zeta}, \quad \rho_\zeta > 0. \tag{A.22}
\]
The trading cost is increasing in the amount of long-term bonds relative to its steady state value. The trading cost is \(\zeta\) in steady state.

The system of equations for the economy consists of 19 equations, (A.3)-(A.21), with the following endogenous variables:
\[c^u_t, c^r_t, h^u_t, h^r_t, h_t, b^u_{L,t}, b^r_{L,t}, b_L, y_t, w_t, i_t, i^* \text{Taylor}_t, R_{L,t}, \pi_t, \tilde{p}_t, F^j_{p,t}, K^j_t.\]

### A.2 Log-linearized equations

We log-linearize the equilibrium conditions of the theoretical model presented in Appendix A.1 around the steady state in which inflation is equal to the target rate of inflation set by the central bank. By doing so, we derive key equations in the system of equations (1)-(16) presented in Section I of the main text. We also derive a log-linearized equation for the long-term yield.

**Euler equation.** Log-linearizing equations (A.3), (A.5), (A.6), (A.8), and (A.22), we obtain\(^3\)
\[
\hat{y}_t = \frac{\omega_u c^u_t}{y} c^u_t + \frac{(1 - \omega_u) c^r_t}{y} \hat{c}^r_t. \tag{A.23}
\]
\[
0 = E_t \left[ -\sigma \left( \hat{c}^u_{t+1} - \hat{c}^u_t \right) + \hat{i}_t - \hat{\pi}_{t+1} + z^b_{t+1} \right], \tag{A.24}
\]
\[
\frac{\zeta}{1 + \zeta} \hat{\beta}_t = E_t \left[ -\sigma \left( \hat{c}^u_{t+1} - \hat{c}^u_t \right) + \hat{R}_{L,t+1} - \hat{\pi}_{t+1} + z^b_{t+1} \right], \tag{A.25}
\]
\[
0 = E_t \left[ -\sigma \left( \hat{c}^r_{t+1} - \hat{c}^r_t \right) + \hat{R}_{L,t+1} - \hat{\pi}_{t+1} + z^b_{t+1} \right], \tag{A.26}
\]
\[
\hat{\zeta}_t = \rho_\zeta \hat{b}_{L,t}. \tag{A.27}
\]

Equation (A.23) can be written as:
\[
\hat{c}^u_t = - \frac{y}{\omega_u c^u_t} \left\{ \hat{y}_t - \frac{(1 - \omega_u) c^r_t}{y} \hat{c}^r_t \right\}.
\]

\(^3\)The variable \(\hat{i}\) represents the deviation of the gross interest rate from the steady state.
Subtracting \( \hat{c}_{t+1}^u \) from \( \hat{c}_t^u \) yields:

\[
\frac{\hat{c}_t^u - \hat{c}_{t+1}^u}{\omega_u c^u} = \frac{y}{\omega_u c^u} \left\{ \hat{y}_{t+1} - \hat{y}_t - \frac{(1 - \omega_u) c^r}{y} \left( \hat{c}_{t+1}^u - \hat{c}_t^u \right) \right\},
\]

\[
= \frac{y}{\omega_u c^u} \left\{ \hat{y}_{t+1} - \hat{y}_t - \frac{(1 - \omega_u) c^r}{y} \left( \hat{R}_{L,t+1} - \hat{\pi}_{t+1} + z_{t+1}^b \right) \right\}, \tag{A.28}
\]

where equation (A.26) was used in the second equality. Substituting equation (A.28) into equation (A.24) yields:

\[
0 = E_t \left\{ -\sigma (\hat{c}_{t+1}^u - \hat{c}_t^u) + \hat{i}_t - \hat{\pi}_{t+1} + z_{t+1}^b \right\},
\]

\[
= E_t \left[ -\frac{\sigma y}{\omega_u c^u} (\hat{y}_{t+1} - \hat{y}_t) + \frac{\sigma y}{\omega_u c^u} \left( 1 - \omega_u \right) c^r \frac{\hat{R}_{L,t+1} - \hat{\pi}_{t+1} + z_{t+1}^b}{\sigma} \right]
\]

\[
+ \hat{i}_t - \hat{\pi}_{t+1} + z_{t+1}^b \right],
\]

or, by using equation (A.3) in steady state,

\[
0 = E_t \left[ -\sigma (\hat{y}_{t+1} - \hat{y}_t) + \frac{(1 - \omega_u)}{y} \hat{R}_{L,t+1} + \frac{\omega_u c^u}{y} \hat{i}_t - \hat{\pi}_{t+1} + z_{t+1}^b \right]. \tag{A.29}
\]

Equation (A.29) shows that the interest rate relevant to the aggregate variables such as output and inflation is the weighted sum of the return of holding the long-term bonds \( \hat{R}_{L,t+1} \) and the short-term interest rate \( \hat{i}_t \). Also, substituting equation (A.28) into equation (A.25) yields:

\[
\frac{\zeta}{1 + \zeta} \hat{\zeta}_t = E_t \left[ -\sigma (\hat{c}_{t+1}^u - \hat{c}_t^u) + \hat{R}_{L,t+1} - \hat{\pi}_{t+1} \right]
\]

\[
= E_t \left[ -\frac{\sigma y}{\omega_u c^u} \left( \hat{y}_{t+1} - \hat{y}_t - \frac{(1 - \omega_u) c^r}{y} \left( \hat{R}_{L,t+1} - \hat{\pi}_{t+1} + z_{t+1}^b \right) \right) \right]
\]

\[
+ \hat{R}_{L,t+1} - \hat{\pi}_{t+1} + z_{t+1}^b \right],
\]

\[
= E_t \left[ -\frac{\sigma y}{\omega_u c^u} (\hat{y}_{t+1} - \hat{y}_t) + \frac{y}{\omega_u c^u} \left( \hat{R}_{L,t+1} - \hat{\pi}_{t+1} + z_{t+1}^b \right) \right],
\]

or, substituting out \( \hat{\zeta}_t \) by using equation (A.27) yields

\[
E_t \left( \hat{R}_{L,t+1} - \hat{\pi}_{t+1} \right) = \sigma E_t (\hat{y}_{t+1} - \hat{y}_t) - E_t (z_{t+1}^b) + \frac{\omega_u c^u}{y} \frac{\zeta}{1 + \zeta} \hat{b}_{L,t}. \tag{A.30}
\]
Combining equations (A.29) and (A.30) yields:

\[
0 = E_t \left[ -\sigma (\hat{y}_{t+1} - \hat{y}_t) + \frac{(1 - \omega_u) c^r}{y} \hat{R}_{L.t+1} + \frac{\omega_u c^u}{y} \hat{\pi}_{t+1} + \hat{z}_b^b \right] \\
= E_t \left[ -\sigma (\hat{y}_{t+1} - \hat{y}_t) + \frac{(1 - \omega_u) c^r}{y} \left( (\hat{y}_{t+1} - \hat{y}_t) - \hat{\pi}_{t+1} + \frac{\omega_u c^u}{y} \frac{\zeta}{1 + \zeta \rho \hat{b}_{L.t}} \right) \right] \\
+ \frac{\omega_u c^u}{y} \hat{\pi}_{t+1} + \frac{\zeta}{1 + \zeta \rho \hat{b}_{L.t}},
\]

or

\[
0 = E_t \left[ -\sigma (\hat{y}_{t+1} - \hat{y}_t) + \hat{i}_t - \hat{\pi}_{t+1} + \hat{z}_b^b + \frac{(1 - \omega_u) c^r}{y} \frac{\zeta}{1 + \zeta \rho \hat{b}_{L.t}} \right],
\]

or

\[
\hat{y}_t = E_t \hat{y}_{t+1} - \frac{1}{\sigma} \left( \hat{i}_t - E_t \hat{\pi}_{t+1} + E_t \hat{z}_b^b \right) - \frac{1}{\sigma} \frac{(1 - \omega_u) c^r}{y} \frac{\zeta}{1 + \zeta \rho \hat{b}_{L.t}},
\]

\[
= E_t \hat{y}_{t+1} - \frac{1}{\sigma} \left( \hat{i}_t - E_t \hat{\pi}_{t+1} \right) - \frac{1}{\sigma} \frac{(1 - \omega_u) c^r}{y} \frac{\zeta}{1 + \zeta \rho \hat{b}_{L.t}} \frac{\rho_b}{\sigma} \hat{z}_b^b.
\]

This equation shows that the central bank’s government bond purchase – a decrease in \( \hat{b}_{L,t} \) – stimulates output, given \( E_t \hat{y}_{t+1} \) and the real rate \( \hat{i}_t - E_t \hat{\pi}_{t+1} \). Since \( \hat{b}_{L,t} \) follows the simple rule (A.17), the equation can be written as equation (12) in the main text, which is reproduced here for convenience:

\[
\hat{y}_t = E_t \hat{y}_{t+1} - \frac{1}{\sigma} \left( (1 - \lambda^*) \hat{i}_t + \lambda^* \hat{i}_t - E_t \hat{\pi}_{t+1} \right) - \chi_b \hat{z}_b^b,
\]

(A.31)

where

\[
\lambda^* = \frac{(1 - \omega_u) c^r}{y} \frac{\zeta}{1 + \zeta \rho \gamma}
\]

\[
\chi_b = \frac{\rho_b}{\sigma}
\]

(A.32)

The case of \( \lambda^* = 1 \) (and \( \alpha = 0 \)) corresponds to the fully effective UMP, which makes the ELB irrelevant. Such a case can be achieved, e.g., when the central bank responds to the shadow rate aggressively enough to satisfy

\[
\gamma = \left[ \frac{(1 - \omega_u) c^r}{y} \frac{\zeta}{1 + \zeta \rho \gamma} \right]^{-1}.
\]

**Phillips curve.** The Phillips curve can be derived from equations (A.10)-(A.13). Log-linearizing equation (A.13) yields:

\[
\hat{p}_t = -\frac{\xi}{1 - \xi} \hat{\Pi}^{p}_{t|t-1},
\]

(A.33)
where

\[ \hat{\Pi}_{t|t-1}^p = (1 - \nu_p) \hat{\pi}_{t-1} - \hat{\pi}_t. \]

Log-linearizing equation (A.10) yields:

\[
\frac{\theta - \lambda_p}{1 - \xi (1 - \lambda_p) \theta} \hat{\Pi}_{t|t-1}^p = \frac{\omega_u K_p^u}{\omega_u K_p^u + (1 - \omega_u) K_p^r} \hat{K}_{p,t}^u + \frac{(1 - \omega_u) K_p^r}{\omega_u K_p^u + (1 - \omega_u) K_p^r} \hat{K}_{p,t}^r
- \frac{\omega_u F_p^u}{\omega_u F_p^u + (1 - \omega_u) F_p^r} \hat{F}_{p,t}^u - \frac{(1 - \omega_u) F_p^r}{\omega_u F_p^u + (1 - \omega_u) F_p^r} \hat{F}_{p,t}^r. \tag{A.34} \]

Combining equations (A.33) and (A.34) leads to:

\[
- \frac{\xi}{1 - \xi (1 - \lambda_p) \theta} [(1 - \nu_p) \hat{\pi}_{t-1} - \hat{\pi}_t] = \frac{\omega_u K_p^u}{\omega_u K_p^u + (1 - \omega_u) K_p^r} \hat{K}_{p,t}^u + \frac{(1 - \omega_u) K_p^r}{\omega_u K_p^u + (1 - \omega_u) K_p^r} \hat{K}_{p,t}^r
- \frac{\omega_u F_p^u}{\omega_u F_p^u + (1 - \omega_u) F_p^r} \hat{F}_{p,t}^u - \frac{(1 - \omega_u) F_p^r}{\omega_u F_p^u + (1 - \omega_u) F_p^r} \hat{F}_{p,t}^r. \tag{A.35} \]

Log-linearizing equation (A.11) and (A.12) yields:

\[
\hat{F}_{p,t}^j = (1 - \xi \delta) \left( -\sigma \hat{c}_t^j + \hat{y}_t \right) + \xi \delta E_t \left( z_{t+1}^b + \frac{1}{1 - \lambda_p} \hat{\Pi}^p_{t+1|t} + \hat{F}_{p,t+1}^j \right),
\]

\[
\hat{K}_{p,t}^j = (1 - \xi \delta) \left( -\sigma \hat{c}_t^j + \frac{1}{\theta} \hat{y}_t - \frac{1}{\theta^2} z_t^a + \hat{w}_t \right) + \xi \delta E_t \left( z_{t+1}^b + \frac{\lambda_p}{1 - \lambda_p} \hat{\Pi}^p_{t+1|t} + \hat{K}_{p,t+1}^j \right),
\]

for \( j \in \{r, u\} \). The term involving \( \hat{F}_{p,t}^u \) and \( \hat{F}_{p,t}^r \) in equation (A.35) is calculated as follows.

\[
\frac{\omega_u F_p^u}{\omega_u F_p^u + (1 - \omega_u) F_p^r} \hat{F}_{p,t}^u + \frac{(1 - \omega_u) F_p^r}{\omega_u F_p^u + (1 - \omega_u) F_p^r} \hat{F}_{p,t}^r
= (1 - \xi \delta) \left( -\sigma \frac{\omega_u F_p^u \hat{c}_t^u}{\omega_u F_p^u + (1 - \omega_u) F_p^r} + \hat{y}_t \right)
+ \xi \delta E_t \left( z_{t+1}^b + \frac{1}{1 - \lambda_p} \hat{\Pi}_{t+1|t}^p + \frac{\omega_u F_p^u}{\omega_u F_p^u + (1 - \omega_u) F_p^r} \hat{F}_{p,t+1}^u + \frac{(1 - \omega_u) F_p^r}{\omega_u F_p^u + (1 - \omega_u) F_p^r} \hat{F}_{p,t+1}^r \right).
\]

Similarly, the term involving \( \hat{K}_{p,t}^u \) and \( \hat{K}_{p,t}^r \) in equation (A.35) is calculated as:

\[
\frac{\omega_u K_p^u}{\omega_u K_p^u + (1 - \omega_u) K_p^r} \hat{K}_{p,t}^u + \frac{(1 - \omega_u) K_p^r}{\omega_u K_p^u + (1 - \omega_u) K_p^r} \hat{K}_{p,t}^r
= (1 - \xi \delta) \left( -\sigma \frac{\omega_u K_p^u \hat{c}_t^u}{\omega_u K_p^u + (1 - \omega_u) K_p^r} + \frac{1}{\theta} \hat{y}_t - \frac{1}{\theta^2} z_t^a + \hat{w}_t \right)
+ \xi \delta E_t \left( z_{t+1}^b + \frac{\lambda_p}{(1 - \lambda_p) \theta} \hat{\Pi}_{t+1|t}^p + \frac{\omega_u K_p^u}{\omega_u K_p^u + (1 - \omega_u) K_p^r} \hat{K}_{p,t+1}^u + \frac{(1 - \omega_u) K_p^r}{\omega_u K_p^u + (1 - \omega_u) K_p^r} \hat{K}_{p,t+1}^r \right).
\]

11
Let the right-hand-side of equation (A.35) be denoted as \( \hat{X}_t \). Then, using the above relationships just derived, \( \hat{X}_t \) can be written as:

\[
\hat{X}_t = (1 - \xi \delta) \left[ \left( \frac{1}{\theta} - 1 \right) \dot{y}_t - \frac{1}{\theta} z^a_t + \dot{w}_t \right] + \xi \delta E_t \left( -\frac{\lambda_p - \theta}{(\lambda_p - 1) \theta} \tilde{\Pi}^p_{t+1|t} + \hat{X}_{t+1} \right)
\]

Because \( \hat{X}_t \) is the right-hand-side of equation (A.35), equation (A.35) can be written as:

\[
-\frac{\xi}{1 - \xi} \frac{\lambda_p - \theta}{(\lambda_p - 1) \theta} (1 - \nu_p) (\hat{\pi}_{t-1} - \hat{\pi}_t) = (1 - \xi \delta) \left[ \left( \frac{1}{\theta} - 1 \right) \dot{y}_t - \frac{1}{\theta} z^a_t + \dot{w}_t \right] + \xi \delta E_t \left( -\frac{\lambda_p - \theta}{(\lambda_p - 1) \theta} \tilde{\Pi}^p_{t+1|t} - \frac{\xi}{1 - \xi} \frac{\lambda_p - \theta}{(\lambda_p - 1) \theta} (1 - \nu_p) (\hat{\pi}_t - \hat{\pi}_{t+1}) \right),
\]

or

\[
\hat{\pi}_t = \frac{\xi (1 - \nu_p)}{(\xi + 1 - \nu_p)} \hat{\pi}_{t-1} + (1 - \xi \delta) \frac{(1 - \xi) (\lambda_p - 1) \theta}{(\lambda_p - \theta) (\xi + 1 - \nu_p)} \left[ \left( \frac{1}{\theta} - 1 \right) \dot{y}_t - \frac{1}{\theta} z^a_t + \dot{w}_t \right] + \frac{\xi \delta}{(\xi + 1 - \nu_p)} E_t \hat{\pi}_{t+1}.
\]

From equations (A.4) and (A.7), the wage \( \dot{w}_t \) can be written as:

\[
\dot{w}_t = \omega_u \left( \sigma \dot{c}_t^u + \frac{1}{\nu} \dot{h}_t^u \right) + (1 - \omega_u) \left( \sigma \dot{c}_t^r + \frac{1}{\nu} \dot{h}_t^r \right),
\]

\[
= \sigma \dot{y}_t + \frac{1}{\nu} \dot{h}_t = \sigma \left( \frac{1}{\nu} \right) \dot{y}_t - \frac{1}{\nu} z^a_t,
\]

where the market clearing conditions (A.3) and (A.18) were used in the second equality and the production function (A.9) was used in the third equality. Since we assume \( c^a = c^r \), the second equality holds. By using the expression for \( \dot{w}_t \), the Phillips curve can be written as

\[
\hat{\pi}_t = \frac{\xi (1 - \nu_p)}{(\xi + 1 - \nu_p)} \hat{\pi}_{t-1} + (1 - \xi \delta) \frac{(1 - \xi) (\lambda_p - 1) \theta}{(\lambda_p - \theta) (\xi + 1 - \nu_p)} \left[ \frac{\nu + \nu (\sigma - 1) + 1}{\nu \theta} \dot{y}_t - \frac{1 + \nu}{\nu \theta} z^a_t \right] + \frac{\xi \delta}{(\xi + 1 - \nu_p)} E_t \hat{\pi}_{t+1}.
\]

In the case of no price indexation to the past inflation rate and a linear production function, that is, in the case of \( \nu_p = 1 \) and \( \theta = 1 \), the Phillips curve collapses to the standard form:

\[
\hat{\pi}_t = \frac{(1 - \xi \delta) (1 - \xi)}{\xi} \left( \sigma + \frac{1}{\nu} \right) \dot{y}_t + \delta E_t \hat{\pi}_{t+1} - \frac{(1 - \xi \delta) (1 - \xi)}{\xi} \frac{1 + \nu}{\nu} z^a_t.
\]

This completes the derivation of equation (16) in the main text, where

\[
\kappa = \frac{(1 - \xi \delta) (1 - \xi)}{\xi} \left( \sigma + \frac{1}{\nu} \right),
\]

\[
\chi_a = \frac{(1 - \xi \delta) (1 - \xi)}{\xi} \frac{1 + \nu}{\nu}.
\]
**Long-term yield.** From equations (A.29) and (A.31), the interest rate relevant to the aggregate variables has the following equality:

\[
\frac{(1 - \omega_u)c^r}{y} E_t \hat{R}_{L,t+1} + \frac{\omega_u c^u}{y} \hat{i}_t = (1 - \lambda^*) \hat{i}_t + \lambda^* \hat{\hat{i}}_t.
\] (A.38)

This equation can be written as

\[
E_t \hat{R}_{L,t+1} = \begin{cases} 
\frac{\lambda^*}{(1 - \omega_u)c^r} \hat{i}_t + \frac{(1 - \lambda^*) y - \omega_u c^u}{(1 - \omega_u)c^r} \hat{i}_t \geq \frac{\hat{i}}{2} \quad \hat{i}_t \geq \frac{\hat{i}}{2} \\
\frac{\lambda}{(1 - \omega_u)c^r} \hat{i}_t + \frac{(1 - \lambda) y - \omega_u c^u}{(1 - \omega_u)c^r} \hat{i}_t < \frac{\hat{i}}{2} 
\end{cases}
\] (A.39)

By using \( R_{L,t+1} = \hat{R}_{L,t+1}(\hat{R}_{L,t} - \mu)/(\hat{R}_{L,t} - \mu) \), which relates the return of holding long-term bonds \( \hat{R}_{L,t+1} \) to the long-term yield \( \hat{R}_{L,t} \), the long-term yield can be written as

\[
\hat{R}_{L,t} = \frac{\hat{R}_L - \mu}{\hat{R}_L} E_t \hat{R}_{L,t+1} + \frac{\mu}{\hat{R}_L} E_t \hat{R}_{L,t+1},
\] (A.40)

where \( \hat{R}_L > \mu \) in steady state. Substitution equation (A.39) into equation (A.40) yields

\[
\hat{R}_{L,t} = \begin{cases} 
\frac{\hat{R}_L - \mu}{\hat{R}_L} \hat{i}_t^* + \frac{\mu}{\hat{R}_L} E_t \hat{R}_{L,t+1} \quad \hat{i}_t^* \geq \frac{\hat{i}}{2} \\
\frac{\hat{R}_L - \mu}{\hat{R}_L} \hat{i}_t^* + \frac{\mu}{\hat{R}_L} E_t \hat{R}_{L,t+1} \quad \hat{i}_t^* < \frac{\hat{i}}{2} 
\end{cases}
\] (A.41)

Equation (A.41) shows that the long-term yield is the discounted sum of the current and future short-term returns, where the short-term return is given by the shadow rate in the non-ELB regime and in the ELB regime it is given by the first two terms in the square brackets in (A.41).

### A.3 Parameterization of the model

Instead of parameterizing the model presented in Appendix A.1, we parameterize the system of log-linearized equations (1)-(16) in the main text. It is worth emphasizing that we use the parameterized model to illustrate the implications of the theoretical model, and not to study the quantiative implications, which would require a more complex system.

The relative risk aversion parameter is set at \( \sigma = 2 \). The discount factor is set close to unity at \( \delta = 0.997 \). The slope of the Phillips curve \( \kappa \) is set at \( \kappa = 0.336 \) using equation (A.36) with the Calvo parameter of \( \xi = 0.75 \) and the Frisch labor elasticity of \( \nu = 0.5. \) In the monetary policy rule, the persistence parameter is set at \( \rho_i = 0.7 \); the inflation coefficient is set at \( r_{\pi} = 1.5 \); the output coefficient is set at \( r_y = 0.5 \). The AR(1) coefficients for the supply and demand shocks are set at \( \rho_a = \rho_b = 0.9 \), and the coefficients \( \chi_b \) and \( \chi_a \) are set according to equations (A.32) and (A.37), respectively. The term premium in steady state is set at \( \zeta = 0.01/4 \). We consider different values for the parameters \( \lambda^* \) and \( \alpha \) (reported in the main text) to study the effects of UMP.

### A.4 Proof of Proposition 1

**Part (i)** Because of the equivalence established in Lemma 1, without loss of generality, consider the case of \( \lambda^* = 1 \) and \( \alpha = 0 \) in the theoretical model. In this case, the variables
\( \hat{y}_t, \hat{\pi}_t, \) and \( \hat{\epsilon}_t^* \) have a closed system of equations, consisting of equation (12) with \( \lambda^* = 1 \), equation (16), and \( \hat{\epsilon}_t^* = \hat{\epsilon}_t^{Taylor} \), where \( \hat{\epsilon}_t^{Taylor} \) is given by equation (3).

In this case, the state of the economy in period \( t \) can be summarized by \( \hat{\epsilon}_{t-1}, \hat{\epsilon}_t^*, z_t^a, \) and \( z_t^b \). Then decision rules for \( \hat{\epsilon}_t^* \) have the following form:

\[
\hat{y}_t = d_{yi}\hat{\epsilon}_t^* + d_{ya}z_t^a + d_{yb}z_t^b,
\]

\[
\hat{\pi}_t = d_{pi}\hat{\epsilon}_t^* + d_{pa}z_t^a + d_{pb}z_t^b,
\]

with coefficients \{ \( d_{yi}, d_{ya}, d_{yb}, d_{pi}, d_{pa}, d_{pb} \) \} uniquely determined under standard assumptions of the model (such as the Taylor principle). With these decision rules, the equation for \( \hat{\epsilon}_t^* \) can be written as

\[
\hat{\epsilon}_t^* = \left[ \rho_i + (1 - \rho_i) (r_{\pi} d_{pi} + r_y d_{yi}) \right] \hat{\epsilon}_{t-1} + \left[ (1 - \rho_i) (r_{\pi} d_{pi} + r_y d_{yi}) + 1 \right] \hat{i}_{t-1}^* + \left[ (1 - \rho_i) (r_{\pi} d_{pb} + r_y d_{yb}) \right] z_t^b.
\]

Let \( y_t = [\hat{y}_t, \hat{\pi}_t, \hat{\epsilon}_t^*]' \) denote the vector of endogenous variables. The decision rule implies

\[
y_t = \begin{bmatrix} d_{yi} & d_{ya} & d_{yb} \\ d_{pi} & d_{pa} & d_{pb} \\ d_{ri} & d_{ra} & d_{rb} \end{bmatrix} \begin{bmatrix} \hat{\epsilon}_{t-1}^* \\ \rho_a z_{t-1}^a + \epsilon^a_t \\ \rho_b z_{t-1}^b + \epsilon^b_t \end{bmatrix} = \begin{bmatrix} d_{yi} & d_{ya} & d_{yb} \\ d_{pi} & d_{pa} & d_{pb} \\ d_{ri} & d_{ra} & d_{rb} \end{bmatrix} \begin{bmatrix} \hat{i}_{t-1}^* \\ \hat{\pi}_{t-1}^* \\ z_{t-1}^a \end{bmatrix} + \begin{bmatrix} d_{yi} & d_{ya} & d_{yb} \\ d_{pi} & d_{pa} & d_{pb} \\ d_{ri} & d_{ra} & d_{rb} \end{bmatrix} \begin{bmatrix} \hat{\epsilon}_{t-1}^* \\ \hat{\epsilon}_{t-1}^* \\ \hat{\epsilon}_{t-1}^* \end{bmatrix} = Cx_{t-1} + D\epsilon_t.
\]

(A.43)

The law of motion for \( x_t = [\hat{\epsilon}_t^*, z_t^a, z_t^b]' \) is:

\[
x_t = \begin{bmatrix} 0 & \rho_a d_{ra} & \rho_b d_{rb} \\ 0 & 0 & \rho_b \end{bmatrix} x_{t-1} + \begin{bmatrix} 0 & 0 & 1 \\ 0 & 0 & 1 \end{bmatrix} \epsilon_t.
\]

(A.44)

Solving equation (A.43) for \( \epsilon_t \), and substituting the outcome in equation (A.44) yields:

\[
x_t = (A - BD^{-1}C) x_{t-1} + BD^{-1}y_t.
\]

If \( A - BD^{-1}C = 0 \), the vector of endogenous variables, \( y_t \), has a VAR(1) representation:

\[
y_t = CBD^{-1}y_{t-1} + D\epsilon_t.
\]

The rest of the proof shows \( A - BD^{-1}C = 0 \). Substituting the matrices \( A \) and \( B \) in equation (A.44) into this condition yields:

\[
D^{-1}C = \begin{bmatrix} 0 & 0 & 0 \\ 0 & \rho_a & 0 \\ 0 & 0 & \rho_b \end{bmatrix}.
\]

14
Further substituting the matrices $C$ and $D$ in equation (A.43) into this condition leads to:

$$A - BD^{-1}C = 0$$

if and only if $d_{yi^*} = d_{yi}(d_{i^*},/d_{i^*})$ and $d_{\pi i^*} = d_{\pi i}(d_{i^*},/d_{i^*})$. Substituting the decision rules into equation (12) yields:

$$\hat{y}_t = \left( d_{yi^*} - \frac{1}{\sigma} + \frac{d_{\pi i}}{\sigma} \right) d_{i^*} \hat{i}_{t-1} + \left( d_{yi^*} - \frac{1}{\sigma} + \frac{d_{\pi i}}{\sigma} \right) d_{i^*}^e_t + ...,$$

where terms related to $z_t^a$ and $z_t^b$ are omitted. Matching coefficients on $\hat{i}_{t-1}$ and $\epsilon_t^i$ of both sides of the equation yields:

$$d_{yi^*} = d_{yi}(d_{i^*},/d_{i^*})$$

These two equations imply $d_{yi^*} = d_{yi}(d_{i^*},/d_{i^*})$. Next, substituting the decision rules into equation (16) yields:

$$\hat{\pi}_t = (\delta d_{\pi i^*} + \kappa d_{yi^*}) \hat{i}_{t-1} + (\delta d_{\pi i^*} d_{i^*} + \kappa d_{yi}) \epsilon_t^i + ...,$$

where terms related to $z_t^a$ and $z_t^b$ are omitted. Matching coefficients on $\hat{i}_{t-1}$ and $\epsilon_t^i$ of both sides of the equation yields:

$$d_{\pi i^*} = \delta d_{\pi i^*} + \kappa d_{yi^*}$$

These two equations imply $d_{yi^*} = d_{yi}(d_{i^*},/d_{i^*})$. Next, substituting the decision rules into equation (16) yields:

$$\hat{\pi}_t = (\delta d_{\pi i^*} + \kappa d_{yi^*}) \hat{i}_{t-1} + (\delta d_{\pi i^*} d_{i^*} + \kappa d_{yi}) \epsilon_t^i + ...,$$

where terms related to $z_t^a$ and $z_t^b$ are omitted. Matching coefficients on $\hat{i}_{t-1}$ and $\epsilon_t^i$ of both sides of the equation yields:

$$d_{\pi i^*} = \delta d_{\pi i^*} + \kappa d_{yi^*}$$

where $d_{yi^*} = d_{yi}(d_{i^*},/d_{i^*})$ is used in the first equation. Solving these two equations for $d_{\pi i^*}$ yields $d_{\pi i^*} = d_{\pi i}(d_{i^*},/d_{i^*})$.

**Part (ii)** Again, without loss of generality, consider the case of $\lambda^* = 1$ and $\alpha = 0$. Under Assumption 1 and the irrelevance hypothesis, the long-term yield can be written as (15) with $\lambda^* = 1$ as

$$\hat{R}_L = \frac{\bar{R}_L - \mu \hat{i}_t^* + \mu \bar{R}_L E_t \hat{R}_{L,t+1}}{\bar{R}_L}.$$

Solving this equation forward yields

$$\hat{R}_{L,t} = \left( \frac{\bar{R}_L - \mu}{\bar{R}_L} \right) E_t \left[ \hat{i}_t^* + \frac{\mu}{\bar{R}_L} \hat{i}_{t+1}^* + \left( \frac{\mu}{\bar{R}_L} \right)^2 \hat{i}_{t+2}^* + ... \right].$$

Because the right-hand-side of the equation depends on information in period $t$, which consist of $\hat{i}_t^*$, $z_t^a$, and $z_t^b$, the long-term interest rate can be written as:

$$\hat{R}_{L,t} = f_i \hat{i}_t^* + f_a z_t^a + f_b z_t^b,$$
where \( f_i^*, f_a, \) and \( f_b \) are coefficients derived by using equation (A.42) as

\[
\begin{align*}
 f_i^* &= \frac{\hat{R}_L - \mu}{\hat{R}_L - d_{i^*i}^{-1} \mu}, \\
 f_a &= \frac{(\hat{R}_L - \rho_d \mu)(\hat{R}_L - d_{i^*i}^{-1} \mu)}{(\hat{R}_L - \rho_d \mu)(\hat{R}_L - d_{i^*i}^{-1} \mu)}, \\
 f_b &= \frac{(\hat{R}_L - \rho_b \mu)(\hat{R}_L - d_{i^*i}^{-1} \mu)}{(\hat{R}_L - \rho_b \mu)(\hat{R}_L - d_{i^*i}^{-1} \mu)}.
\end{align*}
\]

Again by using equation (A.42) the equation for the long-term yield can be written as:

\[
\hat{R}_{L,t} = f_i^* d_{i^*i}^{-1} \hat{i}_{t-1}^* + f_i^* d_{i^*i}^{-1} \epsilon_t^i + (f_i^* d_{i^*a} + f_a) z_t^a + (f_i^* d_{i^*b} + f_b) z_t^b.
\]

Define \( y_t \equiv [\hat{y}_t, \hat{\pi}_t, \hat{R}_{L,t}]', \ x_t \equiv [\hat{i}_{t-1}^*, z_t^a, z_t^b]', \) and \( \epsilon_t = [\epsilon_t^i, \epsilon_t^a, \epsilon_t^b]' \). Then, the state space representation for \( y \) is

\[
y_t = \begin{bmatrix} d_{yi} & \rho_a d_{ya} & \rho_b d_{yb} \\ d_{\pi i} & \rho_a d_{\pi a} & \rho_b d_{\pi b} \\ f_i^* d_{i^*i} & \rho_a (f_i^* d_{i^*a} + f_a) & \rho_b (f_i^* d_{i^*b} + f_b) \end{bmatrix} x_t + \begin{bmatrix} d_{yi} & d_{ya} & d_{yb} \\ d_{\pi i} & d_{\pi a} & d_{\pi b} \\ f_i^* d_{i^*i} & f_i^* d_{i^*a} + f_a & f_i^* d_{i^*b} + f_b \end{bmatrix} \epsilon_t = C x_{t-1} + D \epsilon_t.
\]

and

\[
x_t = \begin{bmatrix} d_{i^*i} & \rho_a & \rho_b d_{i^*b} \\ 0 & \rho_a & 0 \\ 0 & 0 & \rho_b \end{bmatrix} x_{t-1} + \begin{bmatrix} d_{i^*i} & d_{i^*a} & d_{i^*b} \\ 0 & 1 & 0 \\ 0 & 0 & 1 \end{bmatrix} \epsilon_t = A x_{t-1} + B \epsilon_t.
\]

Similar to the part (i) in Proposition 1, a solution for \( y_t \) has a VAR(1) representation if and only if \( A - B D^T C = 0 \). This condition holds if and only if \( d_{yi} = d_{yi}(d_{i^*i}/d_{i^*i}) \) and \( d_{\pi i} = d_{\pi i}(d_{i^*i}/d_{i^*i}) \). The latter two conditions hold as shown in Part (i).

### A.5 Proof of Proposition 2

We show that equations (1), (2), (3), (12), and (16) can be written in the empirical structural form of equations (17a), (17b), and (17c). This will prove the proposition since the structural form has a piecewise linear representation, as explained in the main text. It is straightforward to see that equations (1), (2), and (3) in the theoretical model can be written in the form of equations (17a) and (17b) in the empirical model. Below, we are going to show that equations (12) and (16) can be represented by the structural form equation (17c).

Without loss of generality, consider a case in which agents forming expectations assuming: \( \lambda^* = 1 \) and \( \alpha = 0 \). When forming expectations about variables in period \( t + 1 \), the initial condition is given by \( \bar{x}_t = [(1 - \lambda^*) \hat{i}_t + \lambda^* \hat{i}_t^{*}, \hat{\pi}_t^*, \hat{z}_t^a, \hat{z}_t^b]' \). Under Assumption 2, the decision rule used for forming expectations about period \( t + 1 \) variables is \( y_{t+1} = C \bar{x}_t + D \epsilon_{t+1} \), where \( C \) and \( D \) are those defined in equation (A.43). From period \( t + s \) onward, for \( s = 2, 3, \ldots \), time \( t + s \) variables are expected in period \( t \) to follow \( y_{t+s} = C \bar{x}_{t+s-1} + D \epsilon_{t+s} \),
where \( \mathbf{x}_t \equiv [\hat{i}_t^*, z_t^a, z_t^b]' \). But, once the time proceeds and becomes period \( t + 1 \), the initial condition is updated to \( \mathbf{x}_{t+1} \) and this is used for forming expectations about \( t + 2 \) variables as \( E_{t+1}y_{t+2} = C\mathbf{x}_{t+1} \). Hence, under the assumption about expectations, the decision rule is given by \( y_{t+s} = C\mathbf{x}_{t+s-1} + D\epsilon_{t+s} \) for \( s = 1, 2, \ldots \). In this system, in every period information is updated and \( \mathbf{x}_{t+s-1} \) is used as an initial condition. The interest rate \( \hat{i}_{t+s-1} \) in the initial condition is treated as if it were an exogenous variable.

By substituting the decision rule into the expected variables, equations (12) and (16) can be written as:

\[
\hat{y}_{t} = \left( -\frac{1}{\sigma} + d_{y\pi} + \frac{d_{\pi\pi}}{\sigma} \right) \left( 1 - \lambda^* \right) \hat{i}_t^* + \lambda^* \hat{i}_t^* + \left( \rho_a d_{ya} + \frac{\rho_a d_{\pi\alpha}}{\sigma} \right) z_t^a + \left( \rho_b d_{yb} + \frac{\rho_b d_{\pi\beta}}{\sigma} - \chi_z \right) z_t^b, \\
(A.45)
\]

\[
-\kappa \hat{y}_t + \hat{\pi}_t = \delta d_{\pi\pi} \left( 1 - \lambda^* \right) \hat{i}_t^* + \lambda^* \hat{i}_t^* + \left( \delta \rho_a d_{\pi\alpha} - \chi_a \right) z_t^a + \delta \rho_b d_{\pi\beta} z_t^b. \\
(A.46)
\]

Since \( z_t^a \) and \( z_t^b \) follow AR(1) processes, equations (A.45) and (A.46) can be written in a matrix form as:

\[
H_1 \begin{bmatrix} \hat{y}_t \\ \hat{\pi}_t \end{bmatrix} = H_2 \begin{bmatrix} (1 - \lambda^*) \hat{i}_t^* + \lambda^* \hat{i}_t^* \end{bmatrix} + H_3 \begin{bmatrix} z_{t-1}^a \\ z_{t-1}^b \end{bmatrix} + H_4 \begin{bmatrix} \epsilon_t^a \\ \epsilon_t^b \end{bmatrix}.
\]

or

\[
\begin{bmatrix} \hat{y}_t \\ \hat{\pi}_t \end{bmatrix} = H_1^{-1} H_2 \begin{bmatrix} (1 - \lambda^*) \hat{i}_t^* + \lambda^* \hat{i}_t^* \end{bmatrix} + H_1^{-1} H_3 \begin{bmatrix} z_{t-1}^a \\ z_{t-1}^b \end{bmatrix} + H_1^{-1} H_4 \begin{bmatrix} \epsilon_t^a \\ \epsilon_t^b \end{bmatrix}. \\
(A.47)
\]

Also, under Assumption 2, the expected values can be written as: \( E_t \mathbf{y}_{t+1} = \mathbf{G} \mathbf{y}_t \), where \( \mathbf{y}_t \equiv [\hat{y}_t, \hat{\pi}_t, (1 - \lambda^*) \hat{i}_t^* + \lambda^* \hat{i}_t^*]' \) and \( \mathbf{G} \equiv \text{CBD}^{-1} \), as derived in the proof of Proposition 1. By using this equation, equations (12) and (16) can be written as:

\[
\chi_z z_t^b = \left( \frac{g_{yy}}{\sigma} + \frac{g_{\pi\pi}}{\sigma} - 1 \right) \hat{y}_t + \left( g_{y\pi} + \frac{g_{\pi\pi}}{\sigma} \right) \hat{\pi}_t + \left( g_{y\pi} + \frac{g_{\pi\pi}}{\sigma} - \frac{1}{\sigma} \right) \left( 1 - \lambda^* \right) \hat{i}_t^* + \lambda^* \hat{i}_t^*, \\
\chi_a z_t^a = (\delta g_{yy} + \kappa) \hat{y}_t + (\delta g_{\pi\pi} - 1) \hat{\pi}_t + \delta g_{\pi\pi} \left( 1 - \lambda^* \right) \hat{i}_t^* + \lambda^* \hat{i}_t^*,
\]

where \( g_{ij} \)’s correspond to elements in the matrix \( \mathbf{G} \). Then, the lagged shocks \( z_{t-1}^b \) and \( z_{t-1}^a \) in equation (A.47) can be represented by a function of \( \mathbf{y}_{t-1} \equiv [\hat{y}_{t-1}, \hat{\pi}_{t-1}, (1 - \lambda^*) \hat{i}_{t-1}^* + \lambda^* \hat{i}_{t-1}^*]' \).

From this result, equation (A.47) is in the same form of equation (17c) in the structural form.

### A.6 Impulse responses to demand and supply shocks

We study impulse responses to a demand shock and a supply shock, respectively, in an ELB regime, using the theoretical model presented in Section I of the main text. We show that the responses differ significantly depending on the effectiveness of UMP.

Figure 1 plots impulse responses of output and inflation in the theoretical model to the contractionary demand shock of \( \hat{c}_{t}^d = 0.25/400 \) under the ELB. The responses are calculated exactly in the same way as those to a monetary policy shock, shown in Figure 2 in the main text. In the case of no UMP (\( \xi = 0 \)), a negative demand shock causes the largest declines in output and inflation. As the effectiveness of UMP increases, i.e., as \( \xi \) increases, the negative responses of output and inflation become smaller.
Figure 1: Impulse responses to a demand shock at the ELB

Figure 2: Impulse responses to a supply shock at the ELB

Figure 2 plots impulse responses of output and inflation to the negative supply shock of $\epsilon_a^t = -0.25/100$ under the ELB. In the case of fully effective UMP ($\xi = 1$), output decreases and inflation increases in response to the negative supply shock, as in the responses in a non-ELB regime. However, as the effectiveness of UMP decreases, the degree of a decrease in output shrinks, and output even increases on impact in response to the negative supply shock in the case of no UMP ($\xi = 0$). This is driven by a stronger increase in inflation under the ELB. Such an increase in inflation mitigates the negative impact of the ELB on output. This effect dominates the direct effect of the negative supply shock, resulting in an increase in output on impact.

While we exclusively focus on monetary policy shocks in this paper, the same co-movement of the variables in response to supply and demand shocks when the economy approaches the ELB would pose a challenge for identifying responses to demand and supply shocks.
B Derivation of the attenuation effect (24)

Start from the definition of the IRF to the monetary policy shock \( \bar{\varepsilon}_{2t} := A_{22}\varepsilon_{2t} \).\(^4\) This is a function of the shock magnitude \( \varsigma \) and horizon \( h \):

\[
IRF_{h,t} (\varsigma) = E( Y_{t+h} | \bar{\varepsilon}_{2t} = \varsigma, x_t) - E( Y_{t+h} | \bar{\varepsilon}_{2t} = 0, x_t) ,
\]

where \( x_t = (x_{1t}, x_{2t})' \), \( x_{it} := C_i X_t + C_i^* X_t^* \) embodies all the relevant history of \( Y_t \) up to period \( t-1 \).\(^5\) We only need to discuss the impact effects, so we set \( h = 0 \) in (B.1) and write \( IRF_{0,t} (\varsigma) = g (\varsigma; x_t) - g (0; x_t) \), where

\[
g (\varsigma; x_t) := E( Y_{1t} | \bar{\varepsilon}_{2t} = \varsigma, x_t) .
\]

Note that, despite the kink in the model, the fact that we are taking expectations with respect to the remaining shocks \( \bar{\varepsilon}_{1t} := A_{11} \varepsilon_{1t} \) implies that the function \( g \) is smooth in both arguments. So, we can consider infinitesimal interventions by computing \( \lim_{\varsigma \to 0} \frac{g(\varsigma; x_t) - g(0; x_t)}{\varsigma} =: \frac{\partial g(\varsigma; x_t)}{\partial \varsigma} \).

Let \( D_t = I_{\varsigma < \hat{\varsigma}} \) denote the indicator that the interest rate is at the ELB. Then, using equation (19) in the main text, we obtain:

\[
g (\varsigma, x_t) = C_1 X_t + C_{12}^* X_{2t} + E( u_{1t} | \bar{\varepsilon}_{2t} = \varsigma, x_t )
- \beta E (D_t (C_2 X_t + C_{22}^* X_{2t} - \hat{\varsigma}_t + u_{2t}) | \bar{\varepsilon}_{2t} = \varsigma, x_t )
= x_{1t} + (I_{k-1} - \beta \gamma)^{-1} \beta \varsigma - \beta E (D_t | \bar{\varepsilon}_{2t} = \varsigma, x_t ) \left( x_{2t} - \hat{\varsigma}_t + \frac{\varsigma}{1 - \gamma \beta} \right)
- \beta E \left( \frac{\gamma \bar{\varepsilon}_{1t}}{1 - \gamma \beta} D_t | \bar{\varepsilon}_{2t} = \varsigma, x_t \right)
= x_{1t} + (I_{k-1} - \beta \gamma)^{-1} \beta \varsigma - \beta \Phi \left( \frac{\hat{\varsigma}_t - x_{2t} - \frac{\varsigma}{1 - \gamma \beta}}{\omega} \right) \left( x_{2t} - \hat{\varsigma}_t + \frac{\varsigma}{1 - \gamma \beta} \right)
+ \beta \varphi \left( \frac{\hat{\varsigma}_t - x_{2t} - \frac{\varsigma}{1 - \gamma \beta}}{\omega} \right).
\]

The second equality in equation (B.3) follows from the definitions of \( x_{it} \) and the fact that:

\[
u_{1t} = (I_{k-1} - \beta \gamma)^{-1} (\bar{\varepsilon}_{1t} + \beta \bar{\varepsilon}_{2t}) , \quad \text{and} \quad u_{2t} := \frac{\gamma \bar{\varepsilon}_{1t} + \bar{\varepsilon}_{2t}}{1 - \gamma \beta} ,
\]

see (Mavroeidis, 2021, equations 32 and 33), and the third equality in equation (B.3) follows from:

\[
E (D_t | \bar{\varepsilon}_{2t} = \varsigma, x_t ) = \Pr ( u_{1t} < \hat{\varsigma}_t - x_{2t} | \bar{\varepsilon}_{2t} = \varsigma, x_t )
= \Pr \left( \frac{\gamma \bar{\varepsilon}_{1t}}{1 - \gamma \beta} < \hat{\varsigma}_t - x_{2t} - \frac{\varsigma}{1 - \gamma \beta} \right)
= \Phi \left( \frac{b - x_{2t} - \frac{\varsigma}{1 - \gamma \beta}}{\omega} \right) , \quad \omega^2 := \text{var} \left( \frac{\gamma \bar{\varepsilon}_{1t}}{1 - \gamma \beta} \right)
\]

\(^4\)Note that the derivation of (24) remains the same if we worked with perturbations to \( \varepsilon_{2t} \) instead of \( \bar{\varepsilon}_{2t} \), but we choose the latter to avoid carrying \( A_{22} \) around in the derivation.

\(^5\)\( x_{1t} \) is the sufficient statistic for the entire history of \( Y_t \) in the conditional expectations, i.e.,

\[E (Y_{t+h} | \bar{\varepsilon}_{2t}, Y_{t-1}, Y_{t-2}, ...) = E (Y_{t+h} | \bar{\varepsilon}_{2t}, x_t) .\]
and
\[
E \left( \frac{\gamma \xi_{1t}^j}{1 - \gamma \beta} D_t \bigg| \xi_{2t} = \zeta, x_t \right) = E \left( \frac{\gamma \xi_{1t}^j}{1 - \gamma \beta} \bigg| \xi_{1t} < i_t - x_{2t} \bigg| \xi_{2t} = \zeta, x_t \right) \\
\times \Pr \left( \frac{\gamma \xi_{1t}^j}{1 - \gamma \beta} < i_t - x_{2t} \bigg| \xi_{2t} = \zeta, x_t \right) \\
= -\omega \phi \left( \frac{i_t - x_{2t} - \zeta}{\omega} \right),
\]
where the second equality in the last expression follows from the independence of \( \xi_{1t} \) from \( \xi_{2t} \) and \( x_t \), and the properties of the truncated standard normal distribution, i.e., \( E \left( z \big| z < a \right) = -\phi \left( a \right) / \Phi \left( a \right) \).

Differentiating equation (B.3) with respect to \( \zeta \) yields:
\[
\frac{\partial g \left( \zeta, x_t \right)}{\partial \zeta} = (I_{k-1} - \beta \gamma)^{-1} \beta - \frac{1}{1 - \gamma \beta} \bar{\beta} \Phi \left( \frac{i_t - x_{2t} - \zeta}{\omega} \right) \\
+ \bar{\beta} \frac{1}{1 - \gamma \beta} \phi \left( \frac{i_t - x_{2t} - \zeta}{\omega} \right) \left( x_{2t} - i_t + \frac{\zeta}{\omega} \right) \\
+ \bar{\beta} \frac{1}{1 - \gamma \beta} \left( \frac{i_t - x_{2t} - \zeta}{\omega} \right) \phi \left( \frac{i_t - x_{2t} - \zeta}{\omega} \right) \\
= (I_{k-1} - \beta \gamma)^{-1} \beta - \frac{1}{1 - \gamma \beta} \bar{\beta} \Phi \left( \frac{i_t - x_{2t} - \zeta}{\omega} \right),
\]
where the first equality follows from the fact that \( \partial \phi \left( z \right) / \partial z = -z \phi \left( z \right) \). Evaluating the above expression at \( \zeta = 0 \) yields the impact effect of a small monetary policy shock on \( Y_{1t} \) in period \( t \), which is a \( k - 1 \) vector, namely,
\[
IR_t := \left. \frac{\partial g \left( \zeta, x_t \right)}{\partial \zeta} \right|_{\zeta=0} = (I_{k-1} - \beta \gamma)^{-1} \beta - \frac{1}{1 - \gamma \beta} \bar{\beta} \Phi \left( \frac{i_t - x_{2t}}{\omega} \right).
\]

If there is no attenuation effect, the impact effect of the monetary policy shock \( \xi_{2t} \) on \( Y_{1t} \) is common across regimes and is given by:
\[
IR_{NA} = (I_{k-1} - \beta \gamma)^{-1} \beta = \frac{\beta}{1 - \gamma \beta},
\]
where the second equality follows from the fact that \( (I_{k-1} - \beta \gamma) \beta = \beta \left( 1 - \gamma \beta \right) \). Therefore,
\[
IR_t = IR_{NA} - \frac{1}{1 - \gamma \beta} \bar{\beta} \Phi \left( \frac{i_t - x_{2t}}{\omega} \right).
\]
The \( j \)th element of the \( k - 1 \) vector \( IR_t \) above can be written as
\[
IR_{j,t} = IR_{j,NA} - \frac{1}{1 - \gamma \beta} \bar{\beta}_j \Phi \left( \frac{i_t - x_{2t}}{\omega} \right) \\
= \frac{\beta_j}{1 - \gamma \beta} - \frac{\beta_j}{1 - \gamma \beta} \bar{\beta}_j \Phi \left( \frac{i_t - x_{2t}}{\omega} \right) \\
= \left( 1 - \frac{\bar{\beta}_j}{\beta_j} \Phi \left( \frac{i_t - x_{2t}}{\omega} \right) \right) IR_{j,NA}.
\]
Renaming $x_{2t} = C_2 X_t + C_{22} X_{-t}$, the one-step ahead forecast of the reduced-form shadow rate, as $i_t^{*\mid t-1}$ yields (24) as required.

C Data description

We construct our quarterly data by taking averages of monthly series. For the U.S., the inflation rate is computed from the implicit price deflator (GDPDEF) as $\pi_t = 400 \times \log(P_t/P_{t-1})$, where $P_t$ is the GDP deflator. The output gap is calculated as $100\% \times (GDPC1 - GDPPOT)/GDPPOT$, where GDPC1 is the series for the U.S. real GDP and GDPPOT is the U.S. real potential GDP. The long-term interest rate is from the 10-year Treasury constant maturity rate (GS10). All these series are from the FRED database.\footnote{The data can be retrieved from the following websites: GDP deflator https://fred.stlouisfed.org/series/GDPDEF; and series to construct the output gap: https://fred.stlouisfed.org/series/GDPC1 and https://fred.stlouisfed.org/series/GDPPOT; the Federal Funds Rate https://fred.stlouisfed.org/series/FEDFUNDS; and the long yield https://fred.stlouisfed.org/series/GS10. The data for the different monetary aggregates is available at: https://fred.stlouisfed.org/categories/24 and http://www.centerforfinancialstability.org/amfm_data.php.}

Money growth data for the U.S. are computed from 12 alternative indicators as listed in Table 1 as $m_t = 400 \times \log(M_t/M_{t-1})$, where $M_t$ is the particular money supply considered. All $M_t$ values are quarterly and computed by taking averages of their corresponding monthly values. The traditional monetary aggregates (MB, M1, M2, M2M,MZM), and securities held outright are from the FRED database. The Divisia monetary aggregates (DIVM1, DIVM2, DIVM2M, DIVMZM, DIVM4) are from the Center for Financial Stability Divisia database.

For Japan, the quarterly call rate, bond yields, and the core CPI are computed as the averages of their monthly counterparts. The quarterly inflation rate is computed from the core CPI (consumption tax changes adjusted) as $\pi_t = 400 \times (CPI_t - CPI_{t-1})/CPI_{t-1}$. The GDP gap is that published by the Bank of Japan. The trend growth is defined by the annualised growth rate of potential GDP from the previous quarter, which comes from the estimates of the Cabinet Office. The interest on reserves (IOR) is constructed from the interest rate that the Bank of Japan applies to the Complementary Deposit Facility.\footnote{The data can be retrieved from the following websites: call rate (Bank of Japan): http://www.stat-search.boj.or.jp/index_en.html; 9-year and 10-year government bond yields (Ministry of Finance): https://www.mof.go.jp/jgbs/reference/interest_rate/data/jgbcm_all.csv; GDP gap (Bank of Japan): https://www.boj.or.jp/en/research/research_data/index.htm; core CPI inflation (Statistics Bureau of Japan): https://www.e-stat.go.jp/stat-search/file-download?statInfId=000031431696&fileKind=1; trend growth rate (Cabinet Office): https://www5.cao.go.jp/keizai3/getsurei-e/index-e.html.}
Table 1: Monetary Aggregates Data used in the Model

| Monetary Aggregate ($M_t$) | Mnemonics in the Corresponding Database | Available Sample Periods  |
|---------------------------|----------------------------------------|--------------------------|
| Monetary Base (MB)         | MBSL                                   | 1948Q1-2019Q1            |
| M1                        | M1SL                                   | 1959Q2-2019Q1            |
| M2                        | M2SL                                   | 1959Q2-2019Q1            |
| M2M                       | M2MSL                                  | 1959Q2-2019Q1            |
| MZM                       | MZMSL                                  | 1959Q2-2019Q1            |
| Securities Held Outright  | WSECOUT                                | 1989Q3-2019Q1            |
| Divisia M1 (DIVM1)         | Divisia M1                             | 1967Q2-2019Q1            |
| Divisia M2 (DIVM2)         | Divisia M2                             | 1967Q2-2019Q1            |
| Divisia M2M (DIVM2M)       | Divisia M2M                            | 1967Q2-2019Q1            |
| Divisia MZM (DIVMZM)       | Divisia MZM                            | 1967Q2-2019Q1            |
| Divisia M4 (DIVM4)         | DM4                                    | 1967Q2-2019Q1            |

D Additional empirical results

Weaker version of IH$_1$. Table 2 shows the results of the weaker version of IH$_1$, i.e., $C_{12} = C'_{12} = \beta = 0$ for inflation and output equations only. As in the baseline CKSVAR specification reported in Table 1 in the main text, 4 lags are selected for the U.S. and 2 lags are selected for Japan. The $p$-values reported in Table 2 show that the weaker version of IH$_1$ is firmly rejected for both countries.

Adding alternative measures of monetary policy. Table 3 shows the results of tests for exclusion of the Federal Funds Rate from a SVAR that includes inflation, the output gap, the 10-year bond yield, and various alternative measures of the growth of monetary aggregates outlined in column (1). Column (3) shows the order of the VAR selected by the AIC, which varies between 3 and 4 lags, consistent with the benchmark model in Table 1 in the main text. Columns (4) and (6) report the likelihood ratio test statistics for the joint exclusion hypothesis and the corresponding asymptotic $p$-values, respectively. These results show that the data strongly and consistently reject the joint exclusion restrictions on the Federal Funds Rate across all the alternative specifications for all measures of money supply, which corroborates the findings in the baseline 4-equation model in Table 1 in the main text.
Table 2: Test for excluding short rates from VAR that includes long rates

Panel A: KSVAR

| p | loglik | pv-p | AIC   | LR   | df | p-val | loglik | pv-p | AIC   | LR   | df | p-val |
|---|--------|------|-------|------|----|-------|--------|------|-------|------|----|-------|
| 5 | -213.4 | -    | 2.62  | 36.08| 12 | 0.000 | 248.1  | -    | -2.18 | 12.74| 12 | 0.389 |
| 4 | -221.5 | 0.446| 2.55  | 33.42| 10 | 0.000 | 239.9  | 0.425| -2.30 | 14.13| 10 | 0.167 |
| 3 | -234.4 | 0.112| 2.53  | 27.12| 8  | 0.001 | 232.2  | 0.471| -2.42 | 14.89| 8  | 0.061 |
| 2 | -266.0 | 0.000| 2.66  | 28.29| 6  | 0.000 | 223.8  | 0.445| -2.53 | 15.70| 6  | 0.015 |
| 1 | -296.7 | 0.000| 2.78  | 24.62| 4  | 0.000 | 184.8  | 0.000| -2.19 | 25.15| 4  | 0.000 |

Panel B: CKSVAR

| p | loglik | pv-p | AIC   | LR   | df | p-val | loglik | pv-p | AIC   | LR   | df | p-val |
|---|--------|------|-------|------|----|-------|--------|------|-------|------|----|-------|
| 5 | -191.3 | -    | 2.60  | 52.08| 22 | 0.000 | 284.7  | -    | -2.42 | 48.79| 22 | 0.001 |
| 4 | -202.7 | 0.290| 2.53  | 44.48| 18 | 0.000 | 277.1  | 0.766| -2.61 | 52.42| 18 | 0.000 |
| 3 | -223.0 | 0.011| 2.53  | 33.32| 14 | 0.003 | 258.1  | 0.081| -2.62 | 42.61| 14 | 0.000 |
| 2 | -256.3 | 0.000| 2.64  | 31.10| 10 | 0.001 | 242.1  | 0.018| -2.68 | 28.23| 10 | 0.002 |
| 1 | -290.2 | 0.000| 2.76  | 27.19| 6  | 0.000 | 204.8  | 0.000| -2.43 | 43.99| 6  | 0.000 |

Note: Panel A reports results for a KSVAR(p) with inflation, output gap, long rate, and policy rate. Panel B reports corresponding results for a CKSVAR(p) that includes shadow rates. The sample period is 1960q1-2019q1 for the U.S. and 1985q3-2019q1 for Japan. Long rates are 10-year government bond yields for the U.S. and 9-year yields for Japan. Under the null hypothesis, the short rate is excluded from the equations for inflation and output only. loglik is the value of the log-likelihood. pv-p is the p-value of the test for lag reduction. AIC is the Akaike information criterion. LR is the value of the LR test statistic for excluding short rates from equations for inflation and output gap. df is the number of restrictions. p-val is the asymptotic \( \chi^2_{df} \) p-value of the test.
Table 3: Test for excluding short rates from VARs that include long rates and money

| Mon. Aggr. | sample        | p  | LR       | df | p-val   |
|------------|---------------|----|----------|----|---------|
| MB         | 1960q1-2019q1 | 3  | 55.05    | 16 | 0.0000  |
| M1         | 1960q3-2019q1 | 3  | 55.50    | 16 | 0.0000  |
| M2         | 1960q3-2019q1 | 3  | 54.77    | 16 | 0.0000  |
| M2M        | 1960q3-2019q1 | 4  | 73.78    | 20 | 0.0000  |
| M2M        | 1960q3-2019q1 | 4  | 79.65    | 20 | 0.0000  |
| M2M        | 1968q3-2019q1 | 4  | 80.68    | 20 | 0.0000  |
| M2M        | 1968q3-2019q1 | 4  | 111.50   | 20 | 0.0000  |
| M2M        | 1968q3-2019q1 | 4  | 110.88   | 20 | 0.0000  |
| M2M        | 1968q3-2019q1 | 4  | 107.10   | 20 | 0.0000  |
| M2M        | 1968q3-2019q1 | 4  | 135.38   | 20 | 0.0000  |
| M2M        | 1990q4-2019q1 | 3  | 94.38    | 16 | 0.0000  |

Note: The estimated model is a KSVAR(p) for the U.S. with inflation, output gap, the Federal Funds Rate, the 10-year government bond yield, and a different measure of money growth in each row. Sample availability varies for each monetary aggregate used. LR is the value of the LR test statistic for the testing that lags of the Federal Funds Rate can be excluded from all other equations in the model, df is the number of exclusion restrictions, and p-val is the asymptotic $\chi^2_{df}$ p-value of the test.

Robustness of test results for the U.S. to the Great Moderation. The test results of the IH over the full sample are subject to a possible misspecification arising from the ‘Great Moderation’, a drop in U.S. macroeconomic volatility in the mid-1980s. Therefore, we assess the robustness of our results by estimating the model and performing the above tests of the IH over the sub-sample which starts in 1984q1. Tables 4 and 5 report the results over this subsample, which correspond to the results reported in Tables 1 and 3 in the main text for the full sample, respectively. The results of the tests of the IH remain the same: the hypothesis is firmly rejected.

Table 4: Test for excluding short rates form VAR that includes long rates post-1984

| p  | loglik | pv-p | AIC | LR  | df | p-val |
|----|--------|------|-----|-----|----|-------|
| 5  | 97.92  | -0.01| 25.63| 18  | 0.11|       |
| 4  | 92.83  | 0.857| -0.17| 28.01| 15  | 0.022 |
| 3  | 85.07  | 0.776| -0.28| 22.31| 12  | 0.034 |
| 2  | 66.06  | 0.064| -0.24| 22.99| 9   | 0.006 |
| 1  | 14.30  | 0.000| -0.27| 5.33 | 6   | 0.502 |

| p  | loglik | pv-p | AIC | LR  | df | p-val |
|----|--------|------|-----|-----|----|-------|
| 5  | 122.37 | -0.07| 61.65| 33  | 0.002|       |
| 4  | 119.99 | 1.000| -0.33| 70.78| 27  | 0.000 |
| 3  | 103.32 | 0.556| -0.37| 48.44| 21  | 0.001 |
| 2  | 77.86  | 0.009| -0.30| 40.06| 15  | 0.000 |
| 1  | 19.29  | 0.000| 0.25 | 13.59| 9   | 0.138 |

Note: The estimated model is a (C)KSVAR(p) for the U.S. with inflation, output gap, Federal Funds Rate, and the 10-year government bond yield. Estimation sample is 1984q1-2019q1. loglik is the value of the log-likelihood. pv-p is the p-value of the test for lag reduction. AIC is the Akaike information criterion. LR is the test statistic for excluding short rates from equations for inflation, output gap and long rates. df is the number of restrictions. p-val is the asymptotic $\chi^2_{df}$ p-value of the test.
Table 5: Testing CSVAR against CKSVAR post-1984

| Country | p | LR  | df | p-val |
|---------|---|-----|----|-------|
| U.S.    | 3 | 31.17 | 15 | 0.008 |

Note: The unrestricted model is a CKSVAR(3) for the U.S. with inflation, output gap, 10-year government bond yields, and the Federal Funds Rate. Sample: 1984q1-2019q1. LR is the test statistics of the restrictions that the model reduces to CSVAR(3). Lag order is chosen by AIC. df is the number of restrictions. p-val is the asymptotic $\chi_2^2$ p-value of the test.

**Robustness of results to the inclusion of credit spreads in the VAR.** For the U.S., we use Moody’s seasoned BAA corporate bond yield relative to 10-year treasury yield as the credit spreads, and the excess bond premium in Gilchrist and Zakrajsek (2012) for Japan. The test results show that our baseline results for IH\(_1\) (Tables 6-7) and IH\(_2\) (Table 8) are robust to the inclusion of credit spreads in the VAR.

Table 6: Test for excluding short rates from VAR that includes long rates and credit spreads

|                | United States | Japan |
|----------------|---------------|-------|
|                | KSVAR         | CKSVAR|
| p | loglik | pv-p | AIC | LR | df | p-val | loglik | pv-p | AIC | LR | df | p-val |
|---|--------|------|-----|----|----|------|--------|------|-----|----|----|------|
| 5 | 298.6 | -   | -2.34 | 40.59 | 24 | 0.018 | 391.8 | -   | -3.52 | 45.64 | 24 | 0.005 |
| 4 | 286.3 | 0.486 | -2.54 | 42.69 | 20 | 0.002 | 373.9 | 0.073 | -3.63 | 38.10 | 20 | 0.009 |
| 3 | 266.5 | 0.086 | -2.62 | 37.49 | 16 | 0.002 | 358.7 | 0.061 | -3.77 | 34.18 | 16 | 0.005 |
| 2 | 232.1 | 0.000 | -2.47 | 18.24 | 12 | 0.109 | 346.3 | 0.073 | -3.96 | 31.84 | 12 | 0.001 |
| 1 | 178.4 | 0.000 | -2.02 | 10.79 | 8  | 0.214 | 303.4 | 0.000 | -3.69 | 44.30 | 8  | 0.000 |

Note: Panel A reports results for a KSVAR(p) with inflation, output gap, long rate, credit spread, and policy rate. Panel B reports corresponding results for a CKSVAR(p) that includes shadow rates. Estimation sample is 1987q2-2019q1 for the U.S. and 1985q3-2019q1 for Japan. Long rates are 10-year government bond yields for the U.S. and 9-year yields for Japan. The credit spreads are Moody’s seasoned BAA corporate bond yield relative to 10-year treasury yield for the U.S., and the excess bond premium introduced by Gilchrist and Zakrajsek (2012) for Japan. loglik is the value of the log-likelihood. pv-p is the p-value of the test for lag reduction. AIC is the Akaike information criterion. LR is the test statistic for excluding short rates from equations for inflation, output gap, credit spread, and long rates. df is the number of restrictions. p-val is the asymptotic $\chi_2^2$ p-value of the test.
Table 7: Test for excluding short rates from VAR that includes long rates and credit spreads

| United States, with Excess Bond Premium |                     |                      |                     |                      |                     |                      |
|----------------------------------------|---------------------|----------------------|---------------------|----------------------|---------------------|----------------------|
|                                       | p                   | loglik               | pv-p                | AIC                  | LR                  | df                   | p-val                |                      |
| Panel A: KSVAR                         |                     |                      |                     |                      |                     |                      |                      |                      |
| 5                                      | 60.9                | -0.979               | 73.83               | 24                   | 0.000               |                      |                      |                      |
| 4                                      | 47.4                | 0.359                | 0.851               | 70.02                | 20                  | 0.000               | 70.4                 | 0.332                | 0.818               | 100.20               | 36                   | 0.000               |
| 3                                      | 22.6                | 0.009                | 0.849               | 54.65                | 16                  | 0.000               | 36.7                 | 0.001                | 0.859               | 69.35                | 28                   | 0.000               |
| 2                                      | -13.8               | 0.000                | 0.975               | 33.35                | 12                  | 0.001               | 0.4                  | 0.000                | 0.929               | 49.91                | 20                   | 0.000               |
| 1                                      | -49.3               | 0.000                | 1.092               | 20.91                | 8                   | 0.007               | -36.6                | 0.000                | 1.006               | 37.12                | 12                   | 0.000               |
| Panel B: CKSVAR                         |                     |                      |                     |                      |                     |                      |                      |                      |
| 5                                      | 86.7                | -0.970               | 113.92              | 44                   | 0.000               |                      |                      |                      |                      |                      |                      |
| 4                                      | 70.4                | 0.332                | 0.818               | 100.20               | 36                   | 0.000               |                      |                      |                      |                      |                      |
| 3                                      | 36.7                | 0.001                | 0.859               | 69.35                | 28                   | 0.000               |                      |                      |                      |                      |                      |
| 2                                      | 0.4                 | 0.000                | 0.929               | 49.91                | 20                   | 0.000               |                      |                      |                      |                      |                      |
| 1                                      | -36.6               | 0.000                | 1.006               | 37.12                | 12                   | 0.000               |                      |                      |                      |                      |                      |

Note: Panel A reports results for a KSVAR(p) with inflation, output gap, long rate, credit spread, and policy rate. Panel B reports corresponding results for a CKSVAR(p) that includes shadow rates. Estimation sample is 1974q2-2019q1. Credit spreads are the excess bond premium in Gilchrist and Zakrajsek (2012). loglik is the value of the log-likelihood. pv-p is the p-value of the test for lag reduction. AIC is the Akaike information criterion. LR is the test statistic for excluding short rates from equations for inflation, output gap, credit spread, and long rates. df is the number of restrictions. p-val is the asymptotic $\chi^2_{df}$ p-value of the test.

Table 8: Testing CSVAR against CKSVAR with credit spreads

| Country               | p   | LR   | df   | p-val |
|-----------------------|-----|------|------|-------|
| U.S.(BAA)             | 3   | 49.58| 19   | 0.000 |
| U.S.(EBP)             | 4   | 53.56| 24   | 0.000 |
| Japan                 | 2   | 40.62| 14   | 0.000 |

Note: The unrestricted model is a CKSVAR(p) in inflation, output gap, long rate, credit spread, and policy rate. Long rate: 10-year government bond yield (U.S.), 9-year government bond yield (Japan). Policy rate: Federal Funds Rate (U.S.), call rate (Japan). Credit spread: Moody’s seasoned BAA corporate bond yield relative to 10-year treasury yield (U.S.), the excess bond premium (U.S. and Japan). Sample: 1987q2-2019q1 (U.S. with BAA spread), 1974q2-2019q1 (U.S. with EBP), 1985q3-2019q1 (Japan). p chosen by AIC. LR is the test statistics of the restrictions that the model reduces to CSVAR(p). df is the number of restrictions. p-val is the asymptotic $\chi^2_{df}$ p-value of the test.

Robustness of Japanese results to 10-year rates. Similarly, we test the robustness of our results for the Japanese data by using the 10-year yields instead. This shortens the available sample for estimation to 1987q4 to 2019q1. Tables 9 and 10 report test statistics for the two types of tests for the IH. From Tables 9 and 10, the IH is rejected across all lags. For the CKSVAR alternative, 2 lags are selected based on the AIC. Table 10 also suggests the rejection of the IH.
Table 9: Test for excluding short rates from VAR for Japan using 10-year bond yields

| p  | loglik | pv-p | AIC | LR  | df  | p-val | loglik | pv-p | AIC | LR  | df  | p-val |
|----|--------|------|-----|-----|-----|-------|--------|------|-----|-----|-----|-------|
| 5  | 285.1  | -    | -2.92 | 37.43 | 18 | 0.005 | 320.5  | -    | -3.17 | 99.85 | 33 | 0.000 |
| 4  | 275.1  | 0.217 | -3.02 | 31.62 | 15 | 0.007 | 307.4  | 0.159 | -3.28 | 86.95 | 27 | 0.000 |
| 3  | 270.5  | 0.605 | -3.20 | 32.05 | 12 | 0.001 | 290.6  | 0.023 | -3.33 | 62.07 | 21 | 0.000 |
| 2  | 256.2  | 0.155 | -3.23 | 24.60 | 9  | 0.003 | 274.3  | 0.004 | -3.39 | 50.90 | 15 | 0.000 |
| 1  | 196.4  | 0.000 | -2.53 | 22.84 | 6  | 0.001 | 212.8  | 0.000 | -2.73 | 38.81 | 9  | 0.000 |

Note: The estimated model is a (C)KSVAR(p) for Japan with inflation, output gap, 10-year government bond yields, and the call rate. Estimation sample is 1987q4-2019q1. loglik is the value of the log-likelihood. pv-p is the p-value of the test for lag reduction. AIC is the Akaike information criterion. LR is the test statistic for excluding short rates from equations for inflation, output gap and long rates. df is the number of restrictions. p-val is the asymptotic $\chi^2_{df}$ p-value of the test.

Table 10: Testing CSVAR against CKSVAR for Japan using 10-year bond yields

| Country | p | LR | df | p-val |
|---------|---|----|----|-------|
| Japan   | 2 | 47.54 | 11 | 0.000 |

Note: The unrestricted model is a CKSVAR(2) for Japan with inflation, output gap, 10-year government bond yields, and the call rate. Estimation sample: 1987q4-2019q1. LR is the test statistics of the restrictions that the model reduces to CSVAR(2). Lag order is chosen by AIC. df is yje number of restrictions. p-val is the asymptotic $\chi^2_{df}$ p-value of the test.

**Power of the irrelevance tests IH$_1$ and IH$_2$.** We use the theoretical model to generate 100 artificial time series under values for the parameter $\xi$ in the range $[0.7, 0.99]$. Table 11 and 12 report the number of rejections for the tests of our irrelevance hypotheses IH$_1$ and IH$_2$, respectively. If our tests are powerful, we would expect the number of rejections to decline with $\xi$ approaching the value of 1 for which the irrelevance hypothesis holds true in the simulated data.

The tables show that the irrelevance tests are powerful. For instance, in the case of the KSVAR as the unrestricted model, the test rejects IH$_1$ at a 1 percent significance level with the rejection rate (frequency) of 99 percent when $\xi = 0.7$, while the rejection rate is 1 percent when $\xi = 0.99$ at the same significance level. Similar results hold for alternative significance levels (columns 2, 3), the CKSVAR as the unrestricted model (Table 11, Panel B), and the test for IH$_2$ (Table 12).
Table 11: Test for excluding short rates from VAR that includes long rates, with simulated data

|      | Panel A: KSVAR |       |       |       |
|------|---------------|-------|-------|-------|
|      | ξ             | (1)   | (2)   | (3)   |
|      | p ≤ 0.01      | p ≤ 0.05 | p ≤ 0.1 |   |
| 0.7  | 99            | 100   | 100   |   |
| 0.75 | 90            | 98    | 99    |   |
| 0.8  | 76            | 92    | 94    |   |
| 0.85 | 58            | 73    | 81    |   |
| 0.9  | 25            | 48    | 60    |   |
| 0.95 | 7             | 19    | 31    |   |
| 0.99 | 1             | 11    | 18    |   |

|      | Panel B: CKSVAR |       |       |       |
|------|-----------------|-------|-------|-------|
|      | ξ               | (1)   | (2)   | (3)   |
|      | p ≤ 0.01        | p ≤ 0.05 | p ≤ 0.1 |   |
| 0.7  | 99              | 100   | 100   |   |
| 0.75 | 93              | 99    | 100   |   |
| 0.8  | 85              | 92    | 94    |   |
| 0.85 | 69              | 84    | 88    |   |
| 0.9  | 42              | 62    | 71    |   |
| 0.95 | 20              | 33    | 45    |   |
| 0.99 | 13              | 25    | 32    |   |

Note: Panel A reports results for a KSVAR(1) with inflation, output gap, long rate, and policy rate. Panel B reports corresponding results for a CKSVAR(1) that includes shadow rates. Estimation sample is data simulated by the calibrated DSGE model for 237 quarters, which equals the length of the U.S. sample in section III.B. For each value of ξ, we run 100 simulations. Columns 2-4 report how many times the irrelevant hypothesis is rejected with 1 percent, 5 percent, and 10 percent significance levels, respectively.
Testing no attenuation effect. We repeat our test of no attenuation in the response of long rates to monetary policy shocks for different sample periods for the U.S. Table 13 shows that no attenuation hypothesis is not rejected if the same sample period of 1990q1–2012q4 is adopted as in Swanson and Williams (2014). If the sample period is extended backwards (starting from 1960q1), the null is rejected at a 5 percent significance level. These results suggest that the responses of the long rate to a monetary policy shock may differ between non-ELB and ELB regimes, depending on the sample period.

E Choleski identification

In our benchmark analysis we use the combination of the ELB identification developed by Mavroeidis (2021) and the sign restrictions similar to those employed by Debortoli et al. (2019) to estimate the UMP parameter $\xi$. This appendix shows the results from using the standard Choleski identification. Figures 3 and 4 reports results for the U.S. and Japan, respectively. They show that the Choleski identification generates several puzzling responses such as the instantaneous decreases in output and inflation in reaction to a negative monetary policy shock. These responses are consistent with the findings in Gertler and Karadi
(2015) for the U.S. and Kubota and Shintani (2022) for Japan, who also show similar responses when using the Choleski identification. Thus, our analysis corroborates the results on the empirically-incongruous responses from the Choleski identification, while showing that the identification based on the combination of the ELB identification and sign restrictions provides plausible responses to monetary policy shocks for the U.S. and Japan when the economy is at the ELB. See Gortz et al. (2023) for a discussion of the issue and some additional corroborative evidence on U.K data.

Figure 3: Choleski identification: Impulse responses to a monetary policy shock in the U.S.

Note: Identified sets of IRFs in 1999q1 and 2009q1 to a -25bps monetary policy shock estimated from CKSVAR(4) model in inflation, output gap, long rate, and the Federal Funds Rate for the U.S. over the period 1960q1-2019q1, identified by the Choleski restrictions that the monetary policy shock has no contemporaneous effects on inflation, output, and the long rate. Dotted lines show the 67 percent asymptotic error bands.
Figure 4: Choleski identification: Impulse responses to a monetary policy shock in Japan

Note: Identified sets of IRFs in 1990q1 and 2010q1 to a -25bps point monetary policy shock estimated using a CKSVAR(2) model in inflation, output gap, long rate, and the call rate for Japan over the period 1985q3-2019q1, identified by the Choleski restrictions that the monetary policy shock has no contemporaneous effects on inflation, output, and the long rate. Dotted lines show the 67 percent asymptotic error bands.

F Shadow rates

Our analysis defines the shadow rate as the short-term interest rate that the central bank would set if there were no ELB. Thus defined, the shadow rate can be interpreted as an indicator of the desired monetary policy stance and we provide estimates of it for Japan and the U.S. Our estimates of the shadow rate do not impose the assumption that the model used to obtain them is constant across regimes, and therefore they explicitly account for the empirical relevance of the ELB over the estimation periods.

The important caveat is that the shadow rates are not identified under our present assumptions. As explained in Mavroeidis (2021), identifying the shadow rate \( i^{*}_t \) in the empirical model (17a)-(17c) in the main text requires knowledge of the parameter \( \alpha \), which scales the reaction function coefficients and policy shocks during the ELB regimes and is not identified without additional information. This parameter is needed in addition to the parameter \( \xi \) that measures the overall impact effect of UMP. In other words, to properly identify the shadow rate and interpret it as a measure of desired policy stance, we need to be able to isolate the effect of FG encapsulated by \( \alpha \). This exercise is beyond the scope of the present paper.
Figure 5: Shadow policy rate for the U.S.

Note: Estimated using a CKSVAR(4) model in inflation, output gap, long rate, and the Federal Funds Rate for the U.S. over the period 1960q1-2019q1 (plotted over the sub-sample 1985q3-2019q1), identified by the sign restrictions that a -25bp monetary policy shock has nonnegative effects on inflation and output and nonpositive effects on the short rate up to four quarters, as well as nonpositive effects on the long rate on impact.

Figure 6: Shadow policy rate for Japan

Note: Estimated using a CKSVAR(2) model in inflation, output gap, long rate, and the call rate for Japan over the period 1985q3-2019q1, identified by the sign restrictions that a -25bp monetary policy shock has nonnegative effects on inflation and output and nonpositive effects on the short rate up to four quarters, as well as nonpositive effects on the long rate on impact.
With the above caveat in mind, we report identified shadow rates under the assumption of $\alpha = 0$. The shadow rates are given in Figures 5 and 6 for the U.S. and Japan, respectively. Different values of $\alpha$ would scale those estimates by a factor $1 + \alpha$. Note that, even with $\alpha = 0$, the shadow rate is only partially identified because it also depends on the parameter $\xi$ that is partially identified. This uncertainty due to $\xi$ is reflected in the shaded areas below the ELB in the figures. In the case of the U.S., the shadow rate dropped sharply soon after the onset of the global financial crisis of 2007-2008. It reached its smallest value at the beginning of 2010 and gradually recovered until the exit from the ELB in 2016. In Japan, the behaviour of the shadow rate is different during the three ELB episodes. During the first episode, the shadow rate fell modestly. In the second episode, it exhibited a persistent decline until the beginning of 2005, followed by a quick reversal. In the third episode, which coincided with the ELB in the U.S., the decline was sharp, and followed by a second wave of declines that lasted until mid-2012. From that point on, the shadow rate exhibited a steady rise, but stayed far from zero even at the end of the sample, and remained near its trough in the second episode.

---

8 Results are available on request.

9 The shadow rate is equal to the observed policy rate above the ELB, see equation (17a) in the main text. Below the ELB, it is given by the equation $\hat{Y}_{2t} = \kappa \hat{Y}_{2t} + (1 - \kappa) b_t$, where $\kappa = (1 + \alpha)(1 - \gamma \beta)/(1 - \xi \gamma \beta)$ and $\hat{Y}_{2t}$ is a “reduced-form” shadow rate that can be filtered from the data using the likelihood, see Mavroeidis (2021).
References

Chen, H., V. Cúrdia, and A. Ferrero (2012). The macroeconomic effects of large-scale asset purchase programmes. *The Economic Journal* 122, F289–F315.

Debortoli, D., J. Galí, and L. Gambetti (2019). On the empirical (ir)relevance of the zero lower bound constraint. In *NBER Macroeconomics Annual 2019, volume 34*. University of Chicago Press.

Gertler, M. and P. Karadi (2015). Monetary policy surprises, credit costs, and economic activity. *American Economic Journal: Macroeconomics* 7(1), 44–76.

Gilchrist, S. and E. Zakrajsek (2012). Credit Spreads and Business Cycle Fluctuations. *American Economic Review* 102(4), 1692–1720.

Gortz, C., W. Li, J. Tsoukalas, and F. Zanetti (2023). Vintage article: the effect of monetary policy shocks in the United Kingdom: an external instruments approach. *Macroeconomic Dynamics*, forthcoming.

Kubota, H. and M. Shintani (2022). Macroeconomic effects of monetary policy in Japan an analysis using interest rate futures surprises. Available at SSRN, University of Tokyo.

Mavroeidis, S. (2021). Identification at the Zero Lower Bound. *Econometrica* 89(6), 2855–2885.

Reifschneider, D. and J. C. Williams (2000). Three lessons for monetary policy in a low-inflation era. *Journal of Money, Credit and Banking* 32(4), 936–966.

Swanson, E. T. and J. C. Williams (2014). Measuring the effect of the zero lower bound on medium- and longer-term interest rates. *American Economic Review* 104(10), 3154–3185.