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Shifting trends, segmented trends, and infrequent permanent shocks

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Abstract

A stochastic trend model is considered in which permanent shocks occur infrequently and randomly. We show that this model is observationally equivalent to shifting/segmented deterministic trend models. Moreover, we show that standard, full-sample time series methods are incapable of distinguishing between small, frequent permanent shocks and large, infrequent permanent shocks. An outlier search, however, reveals substantial evidence of large, infrequent shocks to the GNP deflator and that these shocks account for most of the persistence in the GNP deflator. For real GNP, evidence of infrequent permanent shocks is weaker.



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