

# Analyses of Public Investment Shock in Japan: Factor Augmented Vector Autoregressive Approach<sup>1</sup>

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## Abstract

We investigate the effect of public investment shock to private consumption, real wage and real effective exchange rate using Factor Augmented Vector Autoregressive (FAVAR) model, which is data rich environment. We obtain the result: although the response of private consumption is still positive similar to previous literatures of Structural VAR analysis about fiscal policy, real effective exchange rate appreciates. These results show that one of “Fiscal policy puzzle” is resolved and we can explain these responses to use the New Open Economy Macroeconomics (NOEM) model with Rule of Thumb (ROT) consumers.

JEL: classification: E62, H32, H54.

Key words: Factor Augmented Vector Autoregressive (FAVAR) model, Fiscal policy puzzle, New Open Economy Macroeconomics (NOEM) model

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