Corrigendum to: Large Bayesian Vector Autoregressions with Stochastic Volatility and Non-Conjugate Priors

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Abstract

The original algorithm contained a mistake that meant the conditional distributions used for the VAR's coefficients were missing a piece of information. We propose a new algorithm that uses the same factorization but includes the missing term. The new, correct algorithm has the same computational complexity as the old, incorrect one (i.e., $\mathcal{O}(N^4)$), and therefore it still allows the estimation of large VARs.

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1 The problem

Consider an N-variable vector autoregression with stochastic volatility

$$y_t = \Pi' x_t + A^{-1}\Lambda_t^{0.5}\epsilon_t, \tag{1}$$

where $t = 1, ..., T$, y_t is an N-dimensional vector, p denotes the lag order, x_t is a $k = Np + 1$ vector containing the lags of y_t and an intercept, $\Pi = (\Pi_0, \Pi_1, ..., \Pi_p)'$ is a $k \times N$ matrix of coefficients, A^{-1} is a lower triangular matrix with ones on its main diagonal, Λ_t is a diagonal matrix with generic j-th element $\lambda_{j,t}$, and $\epsilon_t \sim iid\ N(0, I_N)$. The reduced-form

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error covariance matrix is $\Sigma_t = A^{-1}\Lambda_t A^{-1\prime}$. Below we will also make use of the lower-triangular Cholesky factor of Σ_t, with elements $\sigma^*_{j,i,t}$. In this note, although we focus on the model with stochastic volatility, the basic results also apply to a homoskedastic version of the model with non-conjugate priors.

The algorithm used in Carriero, Clark, and Marcellino (2019) aimed to simulate the conditional joint posterior distribution of the VAR autoregressive coefficients Π:

$$vec(\Pi)|y, \Sigma_T \sim N(\bar{\mu}_\Pi, \overline{\Omega}_\Pi), \tag{2}$$

where Σ_T contains the entire history of the error variance matrix Σ_t and y contains the entire history of the observables y_t. The algorithm intended to do so by using the following factorization of the joint distribution:

$$\begin{aligned} p(\Pi \,|\, y, \Sigma_T) \;\; = \;\; & p(\pi^{(1)} \,|\, y, \Sigma_T) \\ & \times p(\pi^{(2)} \,|\, \pi^{(1)}, y, \Sigma_T) \\ & \vdots \\ & \times p(\pi^{(N)} \,|\, \pi^{(N-1)}, \ldots, \pi^{(1)}, y, \Sigma_T), \end{aligned} \tag{3}$$

with generic element

$$p(\pi^{(j)} \,|\, \pi^{(j-1)}, \ldots, \pi^{(1)}, y, \Sigma_T), \tag{4}$$

where $\pi^{(j)}$ denotes the vector of coefficients for equation j, appearing in the j-th column of the matrix

$$\Pi = \left[\begin{array}{ccccccc} \pi^{(1)} & \vdots & \pi^{(j-1)} & \pi^{(j)} & \pi^{(j+1)} & \vdots & \pi^{(N)} \end{array} \right].$$

This triangular factorization breaks down the joint distribution into a sequence of distributions of the generic coefficients $\pi^{(j)}$, i.e., the coefficients appearing in the j-th equation of the VAR. Therefore, an algorithm drawing in sequence from the distribution at the top of expression (3) and proceeding step by step toward the last distribution at the bottom will obtain the desired joint distribution.

In the paper, this strategy was pursued by drawing $\pi^{(j)}$ from a Gaussian distribution with mean $\bar{\mu}_{\Pi\{j\}} = \overline{\Omega}_{\Pi\{j\}} \left\{ \underline{\Omega}^{-1}_{\Pi\{j\}} \underline{\mu}_{\Pi\{j\}} + \sum_{t=1}^{T} x_t \sigma^{*-2}_{j,j,t} y^*_{j,t} \right\}$ and variance $\overline{\Omega}^{-1}_{\Pi\{j\}} = \underline{\Omega}^{-1}_{\Pi\{j\}} + \sum_{t=1}^{T} x_t \sigma^{*-2}_{j,j,t} x'_t$, where $\underline{\mu}_{\Pi\{j\}}$ and $\underline{\Omega}^{-1}_{\Pi\{j\}}$ denote, respectively, the prior mean and prior variance of $\pi^{(j)}$, and $y^*_{j,t} = y_{j,t} - (\sigma^*_{j,1,t}\epsilon_{1,t} + \cdots + \sigma^*_{j,j-1,t}\epsilon_{j-1,t})$.[1] However, this distribution does not have p.d.f. (4), a fact pointed out in Bognanni (2021). Instead, the distribution used has p.d.f.

$$p(\pi^{(j)} \,|\, \pi^{(j-1)}, \ldots, \pi^{(1)}, y^{(1)}, ..., y^{(j-1)}, x, \Sigma_T), \tag{5}$$

[1] In the published version of the paper, the inverse error variance $\sigma^{*-2}_{j,j,t}$ was erroneously written as $\sigma^{*-1}_{j,j,t}$. The code and application results did not reflect this typo.

where $y^{(j)}$ denotes the time series of the j-th variable and x contains the entire history of the variables x_t that appear on the right-hand side of each equation of the VAR. Therefore, the distribution generated by the algorithm described in the paper is:

$$\begin{aligned}
&p(\pi^{(1)} \mid y^{(1)}, x, \Sigma_T) \\
&\times p(\pi^{(2)} \mid \pi^{(1)}, y^{(1)}, y^{(2)}, x, \Sigma_T) \\
&\vdots \\
&\times p(\pi^{(N)} \mid \pi^{(N-1)}, \ldots, \pi^{(1)}, y^{(1)}, y^{(2)}, ..., y^{(N)}, x, \Sigma_T), \qquad (6)
\end{aligned}$$

and not (3).

The difference between (3) and (6) lies in the conditioning sets for the j-th equation coefficients $\pi^{(j)}$, which in (3) includes all the dependent variables $(y^{(1)}, y^{(2)}..., y^{(N)})$, but in (6) includes the dependent variables only up to equation j $(y^{(1)}, y^{(2)}..., y^{(j)})$. This difference implies that a term goes missing, involving the information about $\pi^{(j)}$ contained in the most recent observations of the dependent variables of equations $j+1, ..., N$. To see this more clearly, consider the simplest case $N = 2$ with the following triangular system:

$$\begin{aligned}
y_{1,t} &= x_t' \pi^{(1)} + \sigma^*_{1,1,t} \epsilon_{1,t} \\
y_{2,t} &= x_t' \pi^{(2)} + \sigma^*_{2,1,t} \epsilon_{1,t} + \sigma^*_{2,2,t} \epsilon_{2,t}.
\end{aligned}$$

The likelihood is $p(y \mid \pi, x, \Sigma_T) \propto p(\epsilon_2 \mid \epsilon_1) p(\epsilon_1) \propto p(y^{(1)} \mid \pi^{(1)}, x, \Sigma_T) p(y^{(2)} \mid y^{(1)}, \pi^{(1)}, \pi^{(2)}, x, \Sigma_T)$, where ϵ_j denotes the entire time series of the j-th disturbance. Assuming an independent prior $p(\pi^{(1)}, \pi^{(2)}) = p(\pi^{(1)}) p(\pi^{(2)})$, the joint posterior distribution of $(\pi^{(1)}, \pi^{(2)})$ is:

$$\begin{aligned}
&p(\pi^{(1)}, \pi^{(2)} \mid y, x, \Sigma_T) \\
&\propto p(y^{(1)} \mid \pi^{(1)}, x, \Sigma_T) p(\pi^{(1)}) \times p(y^{(2)} \mid y^{(1)}, \pi^{(1)}, \pi^{(2)}, x, \Sigma_T) p(\pi^{(2)}) \\
&= p(\pi^{(1)} \mid y^{(1)}, x, \Sigma_T) p(y^{(1)} \mid x, \Sigma_T) \times p(\pi^{(2)} \mid y^{(1)}, y^{(2)}, \pi^{(1)}, x, \Sigma_T) \underline{p(y^{(2)} \mid y^{(1)}, \pi^{(1)}, x, \Sigma_T)} \\
&\propto p(\pi^{(1)} \mid y^{(1)}, x, \Sigma_T) \underline{p(y^{(2)} \mid y^{(1)}, \pi^{(1)}, x, \Sigma_T)} \times p(\pi^{(2)} \mid y^{(1)}, y^{(2)}, \pi^{(1)}, x, \Sigma_T) \qquad (7) \\
&= p(\pi^{(1)} \mid y^{(1)}, y^{(2)}, x, \Sigma_T) p(y^{(2)} \mid y^{(1)}, x, \Sigma_T) \times p(\pi^{(2)} \mid y^{(1)}, y^{(2)}, \pi^{(1)}, x, \Sigma_T) \\
&\propto p(\pi^{(1)} \mid y^{(1)}, y^{(2)}, x, \Sigma_T) \times p(\pi^{(2)} \mid y^{(1)}, y^{(2)}, \pi^{(1)}, x, \Sigma_T). \qquad (8)
\end{aligned}$$

Note that (8) coincides with expression (3), whereas (7) consists of expression (6) *times* the underlined term $\underline{p(y^{(2)} \mid y^{(1)}, \pi^{(1)}, x, \Sigma_T)}$, which is therefore missed by the algorithm used in the paper. The missing term contains information about $\pi^{(1)}$ embedded in $y^{(2)}$. Since all the lagged values of all of the variables of the VAR (denoted x) are already in the conditioning set, the extra information that gets lost is that contained in the contemporaneous values $y_t^{(2)}$. This information must be included in order to obtain the target distribution via the correct factorization (3).

2 The solution

The above derivations show one way forward to correct the paper's original algorithm: We could simply add back the missing terms. This is in principle doable, but for general N this approach might get messy and has computational complexity $O(N^5)$. Instead, there is an alternative approach that is cleaner and keeps the complexity at $O(N^4)$.

Consider again the factorization in (3), but this time rather than using it to produce a single Monte Carlo draw from the joint posterior of π, we use it to build a sequence of Gibbs sampler draws from the conditional posteriors of $\pi^{(j)}$, for $j = 1, ...N$. Specifically, one can sample from the joint distribution $\Pi|y, \Sigma_T$ by cycling through the full conditional distributions

$$\pi^{(j)} \,|\, y, \Sigma_T, \pi^{(-j)} \tag{9}$$

for $j = 1, \ldots, N$, where $\pi^{(j)}$ is the j-th column of the $k \times N$ matrix Π, i.e., the vector of coefficients appearing in equation j, and $\pi^{(-j)} = (\pi^{(1)'}, \ldots, \pi^{(j-1)'}, \pi^{(j+1)'}, \ldots, \pi^{(N)'})'$ collects all the coefficients in the remaining equations.

Notice that — by virtue of the triangular factorization — at each iteration j, for updating the value of the sampled $\pi^{(j)}$, we only need to use information associated with equations j and higher. Indeed, the kernel of the p.d.f. of (9) can be built by multiplying the $N - j + 1$ densities appearing in the rows $j, ..., N$ of the factorization in (3):

$$\begin{aligned} p(\pi^{(j)} \,|\, y, \Sigma_T, \pi^{(-j)}) \quad \propto \quad & p(\pi^{(j)} \,|\, \pi^{(1)}, ..., \pi^{(j-1)}, y, \Sigma_T) \\ & \vdots \\ & \times p(\pi^{(N)} \,|\, \pi^{(N-1)}, \ldots, \pi^{(1)}, y, \Sigma_T). \end{aligned} \tag{10}$$

Cycling through (10) for $j = 1, ..., N$ will deliver draws from the desired joint distribution.

This new algorithm is based on the same triangularization (3) for which the incorrect one was conceived. But there are some key differences: i) Rather than using a sequence of N equations, it uses a sequence of N systems of $N - j + 1$ equations; and ii) rather than jointly drawing the VAR's coefficients Π in a single Gibbs step, it blocks the VAR's coefficients equation-by-equation, using N Gibbs steps. These features imply that the algorithm makes a few more computations than the incorrect one, and that it produces more correlated draws, which might slow down mixing. However, this new algorithm preserves the main feature that made the original (but incorrect) algorithm so appealing: It has the computational complexity of $O(N^4)$, which allows estimating and forecasting with very large VARs.

3 Practical implementation

To make this approach operational, consider the triangular representation of the system:

$$\tilde{y}_t = Ay_t = A\Pi' x_t + \Lambda_t^{0.5}\epsilon_t = A(x_t'\Pi)' + \Lambda_t^{0.5}\epsilon_t, \tag{11}$$

which can be expressed as the following system of equations:

$$\begin{aligned}
\tilde{y}_{1,t} &= x_t'\pi^{(1)} + \lambda_{1,t}^{0.5}\epsilon_{1,t} \\
\tilde{y}_{2,t} &= a_{2,1}x_t'\pi^{(1)} + x_t'\pi^{(2)} + \lambda_{2,t}^{0.5}\epsilon_{2,t} \\
\tilde{y}_{3,t} &= a_{3,1}x_t'\pi^{(1)} + a_{3,2}x_t'\pi^{(2)} + x_t'\pi^{(3)} + \lambda_{3,t}^{0.5}\epsilon_{3,t} \\
&\vdots \\
\tilde{y}_{N,t} &= a_{N,1}x_t'\pi^{(1)} + \cdots + a_{N,N-1}x_t'\pi^{(N-1)} + x_t'\pi^{(N)} + \lambda_{N,t}^{0.5}\epsilon_{N,t},
\end{aligned} \tag{12}$$

where $\tilde{y}_t = Ay_t$ is a vector with generic j-th element $\tilde{y}_{j,t} = y_{j,t} + a_{j,1}y_{1,t} + \cdots + a_{j,j-1}y_{j-1,t}$.

The recursive system (12) is a re-parameterization of the recursive system appearing on page 142 of the paper, and it is observationally equivalent to it. It makes clear the problematic feature that was hidden in the terms $\sigma^*_{j,1,t}\epsilon_{1,t}, \cdots, \sigma^*_{j,j-1,t}\epsilon_{j-1,t}$ appearing in the representation used in the paper: The coefficients $\pi^{(j)}$ of equation j influence not only equation j, but also the following equations $j+1, ..., N$, which is yet another way of seeing that these equations have some extra information about $\pi^{(j)}$ that the old algorithm missed.

Importantly though, it remains true that, when conditioning on Σ_T, equations $1, ..., j-1$ have no information about the coefficients of equation j. Indeed the kernel of the joint posterior of Π is:

$$p(\Pi \,|\, y, x, \Sigma_T) \propto \exp\left(-\frac{1}{2}\sum_{t=1}^{T}\left\{\begin{array}{c} \frac{1}{\lambda_{1,t}}(\tilde{y}_{1,t} - x_t'\pi^{(1)})^2 \\ +\frac{1}{\lambda_{2t}}(\tilde{y}_{2,t} - a_{2,1}x_t'\pi^{(1)} - x_t'\pi^{(2)})^2 \\ \vdots \\ +\frac{1}{\lambda_{N,t}}(\tilde{y}_{N,t} - a_{N,1}x_t'\pi^{(1)} - ... - a_{N,N-1}x_t'\pi^{(N-1)} - x_t'\pi^{(N)})^2 \end{array}\right\}\right) p(\Pi).$$

With coefficient priors $\pi^{(j)} \sim N(\underline{\mu}_{\pi^{(j)}}, \underline{\Omega}_{\pi^{(j)}})$, $j = 1, ...N$ that are independent across equations,[2] the first $j-1$ elements in the quadratic term above do not contain $\pi^{(j)}$. It follows that the conditional posterior density $p(\pi^{(j)} \,|\, y, \Sigma_T, \pi^{(-j)})$ can be obtained as in (10), using the

[2]The assumption of independence across equations covers most of the practical implementations of VARs. If necessary, it could be relaxed while maintaining the same triangular structure. This would entail using the properties of the multivariate normal to derive a triangular factorization for the prior in which $\pi^{(j)}$ appears only in equation $j, ..., N$. While this requires the inversion of large matrices, such inversions need to be performed only once, outside the main MCMC algorithm, and therefore with not much computational cost.

subsystem composed of the last $N-j+1$ equations of (12). This density has a multivariate normal distribution

$$(\pi^{(j)} \mid y, \Sigma_T, \pi^{(-j)}) \sim \mathcal{N}(\overline{\mu}_{\pi^{(j)}}, \overline{\Omega}_{\pi^{(j)}}), \tag{13}$$

with

$$\overline{\Omega}^{-1}_{\pi^{(j)}} = \underline{\Omega}^{-1}_{\pi^{(j)}} + \textstyle\sum_{i=j}^{N} a_{i,j}^2 \sum_{t=1}^{T} \dfrac{1}{\lambda_{i,t}} x_t x_t' \tag{14}$$

$$\overline{\mu}_{\pi^{(j)}} = \overline{\Omega}_{\pi^{(j)}} \left(\underline{\Omega}^{-1}_{\pi^{(j)}} \underline{\mu}_{\pi^{(j)}} + \textstyle\sum_{i=j}^{N} a_{i,j} \sum_{t=1}^{T} \dfrac{1}{\lambda_{i,t}} x_t z_{i,t} \right), \tag{15}$$

where $z_{j+l,t} = \tilde{y}_{j+l,t} - \sum_{i \neq j, i=1}^{j+l} a_{j+l,i} x_t' \pi^{(i)}$, for $l = 0, ..., N-j$, and $a_{i,i} = 1$. The posterior moments as expressed in equations (14) and (15) make clear that, in estimating equation j, information is used from not only that equation but also equations $j+1$ through N. In some software packages, computations may be fastest using sums of moments as in equations (14) and (15).

In what follows we provide an alternative expression for the moments (14) and (15) that works more efficiently in the commonly used Matlab software package. Define

$$\Pi^{[j=0]} = \left[\begin{array}{ccccccc} \pi^{(1)} & \vdots & \pi^{(j-1)} & 0_{k\times 1} & \pi^{(j+1)} & \vdots & \pi^{(N)} \end{array} \right]$$

as the $k \times N$ matrix of coefficients Π , where in column j the coefficient vector $\pi^{(j)}$ has been replaced by a $0_{k\times 1}$ vector. The equations of (12) involving $\pi^{(j)}$ are:

$$\underset{(N-j+1)\times N}{A^{(j:N,1:N)}} \left(\underset{N\times 1}{y_t} - \underset{N\times 1}{\Pi^{[j=0]\prime} x_t} \right) = \underset{(N-j+1)\times 1}{A^{(j:N,j)}} \underset{1\times k}{\pi^{(j)\prime}} \underset{k\times 1}{x_t} + \underset{(N-j+1)\times 1}{\varepsilon_t^{(j:N)}},$$

where $\varepsilon_t^{(j:N)}$ denotes the sub-vector of $\Lambda_t^{0.5}\varepsilon_t$ corresponding to variables j through N (here, for simplicity, we subsume the volatilities into the innovation vector). Transposing and stacking all of the equations for $t = 1, ..., T$ yields:

$$(y - X\Pi^{[j=0]}) A^{j:N,1:N)\prime} = X\pi^{(j)} A^{(j:N,j)\prime} + \varepsilon^{(j:N)},$$

where the matrices y, X, and $\varepsilon^{(j:N)}$ have dimensions $T \times N$, $T \times k$, and $T \times (N-j+1)$, respectively. Vectorizing the system yields:

$$vec((y - X\Pi^{[j=0]}) A^{(j:N,1:N)\prime}) = (A^{(j:N,j)} \otimes X)\pi^{(j)} + vec\left(\varepsilon^{(j:N)}\right).$$

Finally, we need to divide by the standard deviation of the errors. Since $vec\left(\varepsilon^{(j:N)}\right) \sim N(0, I_{N-j+1} \otimes \Lambda_{1:T,j:N})$, we obtain:

$$Y^{(j)} = X^{(j)}\pi^{(j)} + u^{(j)}, \tag{16}$$

with

$$\underset{T(N-j+1)\times 1}{Y^{(j)}} = vec((y - X\Pi^{[j=0]})A^{(j:N,1:N)'})./vec(\Lambda^{0.5}_{(1:T,j:N)}) \quad (17)$$

$$\underset{T(N-j+1)\times k}{X^{(j)}} = (A^{(j:N,j)} \otimes X)./vec(\Lambda^{0.5}_{(1:T,j:N)}), \quad (18)$$

where $u^{(j)} \sim N(0, I_{T(N-j+1)})$ and ./ is the Matlab element-by-element division operator. The model in (16) is a Gaussian linear regression model, and the likelihood moments $X^{(j)\prime}X^{(j)}$ and $X^{(j)\prime}Y^{(j)}$ can be combined with the prior to obtain an equivalent expression for the posterior moments appearing in (14) and (15):

$$\overline{\Omega}^{-1}_{\pi^{(j)}} = (\underline{\Omega}^{-1}_{\pi^{(j)}} + X^{(j)\prime}X^{(j)}) \quad (19)$$

$$\overline{\mu}_{\pi^{(j)}} = \overline{\Omega}_{\pi^{(j)}}(\underline{\Omega}^{-1}_{\pi^{(j)}}\underline{\mu}_{\pi^{(j)}} + X^{(j)\prime}Y^{(j)}). \quad (20)$$

4 Application results

In the interest of brevity, in this section we limit the presentation of results to those on computational gains and mixing, computed using the monthly macroeconomic data set used in Carriero, et al. (2019). (The data set consists of time series from the FRED-MD data set, for the period January 1960 to December 2014, with 13 lags in each VAR.) A supplemental online appendix provides a full set of updates of the results of the paper based on the correct triangular algorithm, along with some additional results. These updated results are not much different with respect to the ones presented in the paper.

Figure 1 illustrates the computational gains arising from the use of the triangular algorithm. The top panel shows the computational time (on a 3.5 GHz Intel Core i7) needed to perform 10 draws as a function of the size of the cross-section using the (correct) triangular algorithm and the system-wide algorithm. The bottom panel compares the gain in theoretical computational complexity (dashed line — which is equal to N^2) with the actual gain in computational time. Since the computational gains become so large that they create scaling problems, results in this figure are displayed using a logarithmic vertical axis.

Compared to the same Figure 1 of the paper, two things have changed. First, the performance of the system-wide algorithm (SWA) is much improved: It now takes 33 seconds to make 10 draws from a model with $N = 20$, while before it took 255 seconds. This improvement is due to our use of the Matlab function ./ (element-by-element division of a matrix object) in computing the analogues of (17) and (18) used for the full system of equations of the SWA, while before we were using a Kronecker product to perform the

same operation.[3] Second, the correct triangular algorithm (CTA) is slower than the earlier incorrect triangular algorithm (TA). For example, for a system of $N = 20$ variables, the correct algorithm takes about 3.25 times as long as the original triangular algorithm. This increased computational cost to the CTA over the original TA comes from the fact that, at each iteration j of the loop across equations, the CTA uses $T \times (N - j + 1)$ observations, while the TA only used T.

However, the main pattern emerging from Figure 1 is still the same as in the paper: The CTA is significantly faster than the SWA, with computational gains growing quadratically, which of course reflects the fact that the SWA and CTA have computational complexity $O(N^6)$ and $O(N^4)$, respectively. For the system of $N = 20$ variables used in the empirical application of the paper (updated in the online appendix to this paper), the CTA is about 13 times faster than the SWA. For $N = 40$, it is about 43 times faster. Finally, note that — in practice, although not documented in Figure 1 — as systems get larger, the CTA becomes the only available option, because the SWA requires matrices of such a size that the storage memory requirements quickly exceed the RAM of the typical desktop computer.

As we mentioned above, because the CTA uses conditional posteriors that block the VAR's coefficients equation-by-equation, whereas the TA did not use such blocking and instead treated the full set of coefficients, the draws generated by the new algorithm are more autocorrelated, which might slow down convergence and reduce mixing. Accordingly, we have run some checks of convergence and mixing. Figure 2 compares the mixing of the CTA algorithm with that of the SWA. The results in these figures are obtained by (1) running the SWA for a total of 22,000 draws, discarding the first 2000 and retaining the remaining 20,000 draws; and (2) running the CTA for the same amount of clock time as the SWA, discarding the first 2000 draws, and then adjusting the skip-sampling of the CTA to reduce the sample to 20,000 retained draws. Note that the scales on the horizontal axes of the SWA (left) and CTA (right) columns differ substantially. These results show that the inefficiency factors obtained by running the two alternative algorithms for the same amount of time are much lower for draws produced by the CTA than those produced by the SWA. The CTA with appropriate skip-sampling can produce in the same amount of time draws many times closer to i.i.d. sampling. Instead, the SWA is slower to mix (in a unit of time).

[3]To the best of our knowledge at the time, the Matlab function ./ required the combined use of the function "repmat" for computing the element-by-element ratios in (17) and (18), which ended up being slower than using a Kronecker division. Instead, in the current version of Matlab, the function ./ will fill out columns of a matrix with the single element of a vector, allowing the element-by-element division of every row of a matrix by a vector.

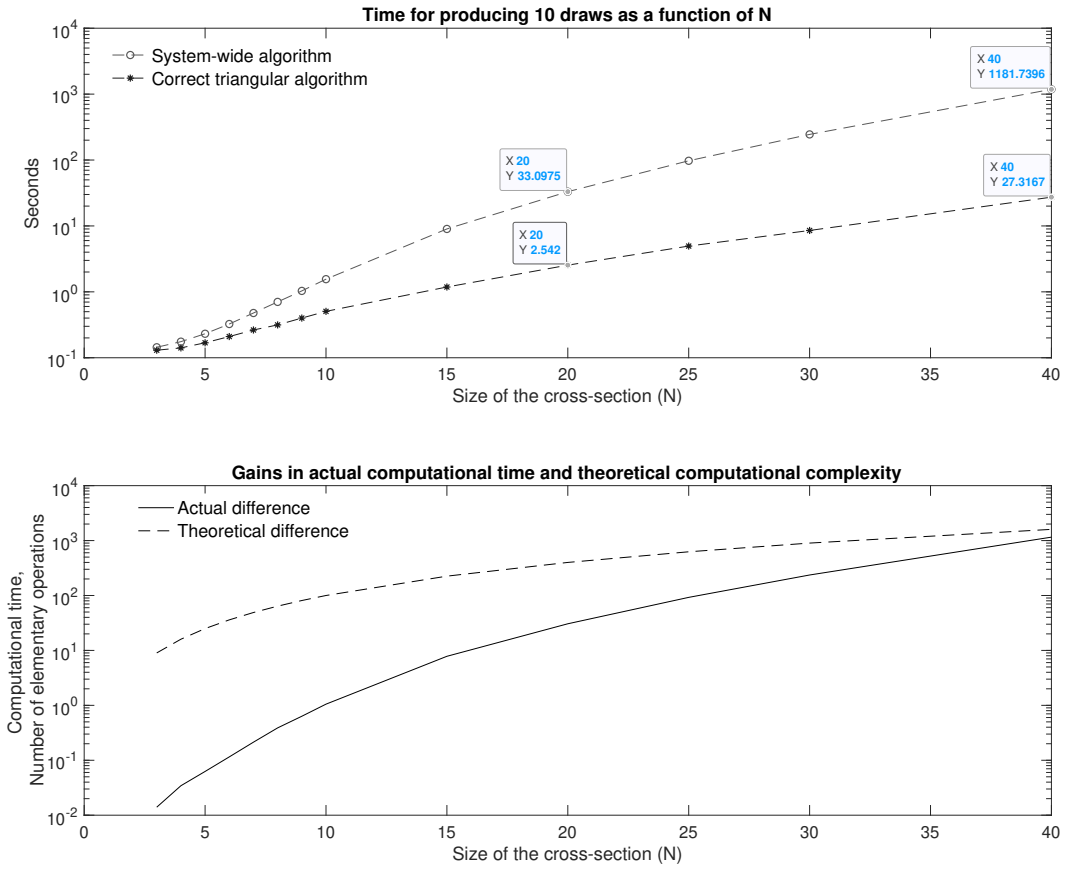

Figure 1: Actual computational time and theoretical computational complexity of the system-wide and correct triangular algorithms. Note that due to the exponential nature of the gains the y-axes are in logarithmic scale. Computational times are computed as the average time (over 10 independent chains) required to make 10 draws on a 3.5 GHz Intel Core i7.

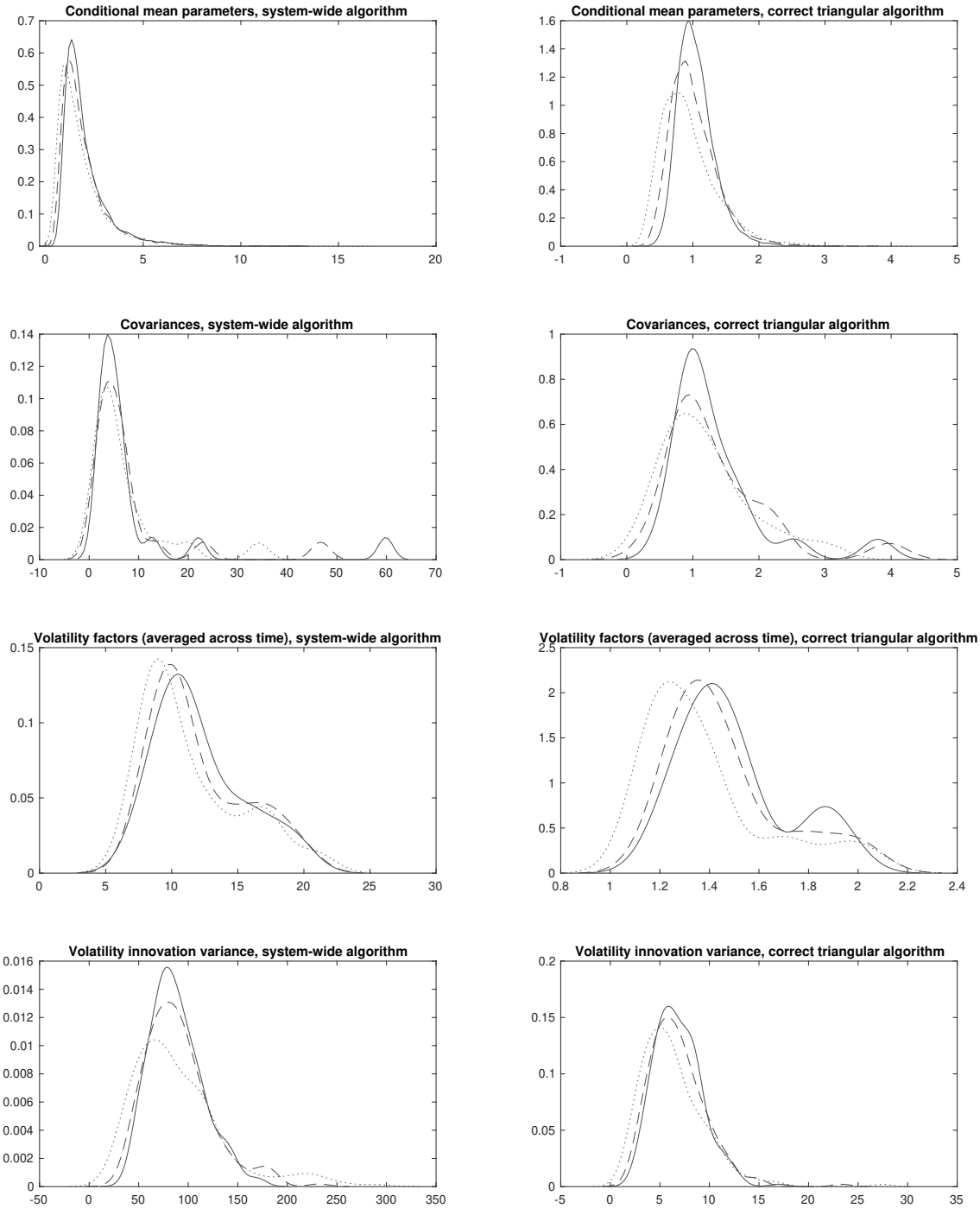

Figure 2: Comparison of inefficiency factors (IF) between the system-wide and correct triangular algorithm. Kernel estimates. Solid, dashed, and dotted lines refer to 4, 8, and 15 percent tapering, respectively. The densities in each sub-plot are computed across the parameters within a given set (from top to bottom: conditional mean coefficients, covariances, states, and covariances of the states). The graphs on the left refer to the system-wide algorithm, while the graphs on the right refer to the correct triangular algorithm.

5 Conclusions

We presented a new, correct algorithm that actually draws from the joint posterior distribution that was intended. The new algorithm is based on the same triangularization (3) for which the incorrect one was conceived, but rather than using a sequence of N equations to obtain a joint draw of the VAR's coefficients in a single Gibbs step, it uses a sequence of N Gibbs steps, each based on sub-systems of $N - j + 1$ equations. While in principle these differences can slow down the speed and reduce the mixing, the new algorithm is still faster and mixes better (for a given amount of computation time) than the system-wide alternative. More importantly, the new algorithm preserves the main feature that made the original (but incorrect) algorithm so appealing: It has the computational complexity of $O(N^4)$, which allows handling very large VARs. The empirical results presented in the paper did not change appreciably after re-estimating the model using the correct algorithm. That being said, in other applications, the algorithm correction could yield more of a difference in estimates.

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