

Abstract

The volatility of economic activity in most G7 economies has moderated over the past 40 years. Also, despite large increases in trade and openness, G7 business cycles have not become more synchronized. After documenting these facts, we interpret G7 output data using a structural VAR that separately identifies common international shocks, the domestic effects of spillovers from foreign idiosyncratic shocks, and the effects of domestic idiosyncratic shocks. This analysis suggests that, with the exception of Japan, a significant portion of the widespread reduction in volatility is associated with a reduction in the magnitude of the common international shocks. Had the common international shocks in the 1980s and 1990s been as large as they were in the 1960s and 1970s, G7 business cycles would have been substantially more volatile and more highly synchronized than they actually were. (JEL: C3, E5)