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Macro Roundup Artcile

Headline: Loose Monetary Policy and Financial Instability

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Tweet: Persistently loose monetary policies are associated with financial crises. A 1pp lower mean in a five-year window increases the probability of a financial crisis in the next 5 to 7 years by 5.5pp and by 15.5 in the following 7-9 years. @MSchularick @sffed

Summary: We are the first to show that, as a causal matter, a loose stance has strong implications for medium-term financial instability. The sample consists of 18 advanced economies over the period from 1870 until 2020. Since the unconditional probability of experiencing a crisis in a 3-year window is 10.5%, these effects are big. Moreover, these results are robust to alternative measures of stance and alternative definitions of financial stability. Lower interest rates in general and loose monetary policy in particular imply, ceteris paribus, higher asset valuations. This opens the door for collateral-driven credit booms. Such credit and asset price booms, in turn, have been identified by the literature as harbingers of financial turmoil.

Primary Topic: Banking

Topics: Banking, Data, Database, Financial Markets, Government/NGO, Monetary Policy, Weekly

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