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Macro Roundup Artcile

Headline: Financial Vulnerability and Macroeconomic Fragility

Article Link: https://libertystreeteconomics.newyorkfed.org/2023/05/financial-vulnerability-and-macroeconomic-fragility/

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Tweet: .@NewYorkFed defines a new metric, the financial stability interest rate r**, which is the rate above which the financial sector tends to see vicious cycle selling and therefore breaks down.

Summary: The chart below shows the responses of credit spreads and output to a one percentage point increase in real interest rates in our calibrated model. The blue solid lines display the responses when the economy is in a tranquil period (r** is almost 1.5 percentage points above r before the shock hits). The one percentage point shock is by construction not large enough to push the economy into the crisis region, with the r**–r gap staying positive throughout. As a consequence, the shock has only modest effects on output and spreads. The red dashed lines display the responses when the economy is much closer to the financially unstable region (r** is only 0.5 percentage points above r before the shock). In this case, the increase in interest rates is enough for the financial accelerator mechanism to kick in, and the response of both spreads and output to the shock is much larger.

Primary Topic: Business Cycle

Topics: Business Cycle, GDP, Government/NGO, Monetary Policy

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