

Financial Stability Considerations in the Conduct of Monetary Policy

Alessio Reghezza

(European Central Bank)

Discussion at the monetary and financial stability policies in a changing economic landscape
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Summary

What the paper does

The paper investigates the interplay of monetary policy, financial conditions and the real economy. It uses a quantile vector autoregressive model using two estimation techniques (simulation and local projection approaches) and five macro variables over the period 2002-2019.

Main findings

1. Surging financial stress (captured by CISS) has strong short-term impact on economic growth.
2. Financial vulnerabilities (captured by SRI) are initially accompanied by subdued financial stress which raises in the medium term.
3. Tightening monetary policy reduces inflationary pressure at the cost of slower real GDP and higher financial stress.
4. QT reduces inflation as short-term rates while having a smaller impact on growth and financial stress.

The effect of MP on financial stability is not a clear cut

Monetary easing

- ▶ **Reduces financial stress** by lowering borrowing costs, improving liquidity, enhancing asset prices, supporting financial institutions, increasing market confidence

- ▶ **Increases vulnerabilities** via risk-taking, underpricing of risks, excessive leverage and overvaluation

Monetary tightening

- ▶ **Enhances financial stress** by reducing household earnings and firms' profitability, raising interest rate burden, reduces asset prices and the value of securities.

- ▶ **Lowers vulnerabilities** through reduced leverage for firms and banks and lower risk-taking

General Comments

1. Nice and topical paper, I really enjoyed reading it!
2. Policy relevant considering the current monetary policy environment
3. Most of the results are also intuitive and expected
4. Explanation of the mechanisms
5. Conventional vs unconventional MP results

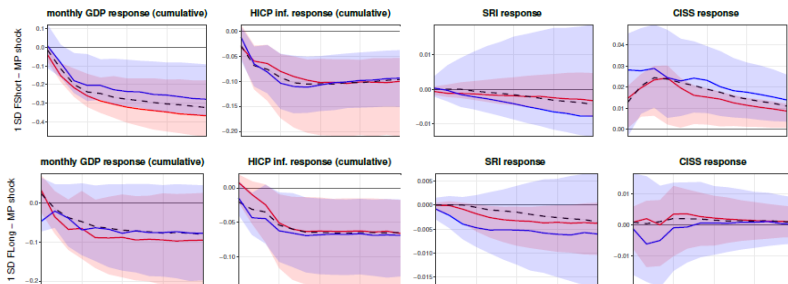
Explanation of the mechanism

- ▶ The paper would benefit from a deeper explanation about the mechanisms through which monetary policy affects financial stress and vulnerabilities.
- ▶ The paper would also benefit from an explanation of the trade-offs involving monetary policy and financial stability (avoid readers/referees to have to go through the paper by Svensson, 2007).
- ▶ Result section lacks of the necessary details to let the reader interpreting the results (e.g. what is the economic reasoning behind UMP not affecting the CISS?).

Financial stability indicators decomposition

- ▶ You find that MP tightening raises financial stress measured through the CISS.
- ▶ The CISS is composed by several indicators: money market, bond market, equity market, financial intermediaries and foreign exchange market.
- ▶ Would it be possible to go granularly and see which stress indicator is more affected by a tightening of monetary policy?

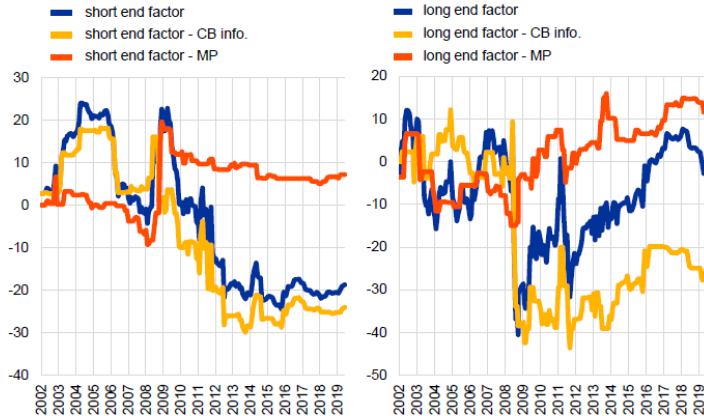
Conventional vs unconventional monetary policy



- ▶ Result is particularly interesting in the current monetary policy environment characterised by the combination of QT and higher ST rates.
- ▶ but...does your sample period include QT or you assume that QE and QT have symmetric effect? Literature suggests they are not symmetric ([Smith and Valcarcel, 2023](#); [Schnabel, 2013](#))
- ▶ Surprising that tighter UMP does not affect the CISS. Deeper and better explanation of why tighter UMP does not affect GDP and CISS as ST rates is needed in the result section. Same for the similar effect on inflation.

Sample period

- ▶ While MP tightening surprises occurred during the sample period, actual MP tightening were very few. Does it make sense to extend the time series to include the current MP tightening?



Notes: The figure shows cumulated factors before and after identification with BBB-rated NFC bond spreads in basis points.