Are the effects of financial market disruptions big or small?*

Regis Barnichon,† Christian Matthes,‡ and Alexander Ziegenbein§

May 14, 2018

Abstract

While episodes of financial distress are followed by large and persistent drops in economic activity, structural time series analyses point to relatively mild and transitory effects of financial market disruptions. We argue that these seemingly contradictory findings are due to the asymmetric effects of financial shocks, which have been predicted theoretically but not taken into account empirically. We propose and estimate a model designed to identify the (possibly asymmetric) effects of financial market disruptions, and we find that a favorable financial shock—an easing of financial conditions—has little effect on output, but an adverse shock has large and persistent effects. The 2007-2008 financial market disruption can explain a large fraction of the 10 percentage points gap between current GDP and its pre-crisis trend.

---

*For helpful comments, we would like to thank Efrem Castelnuovo, Luca Fornaro, Jordi Gali, Guillaume Horny, Oscar Jordà, Karel Mertens, Giovanni Pellegrino, Ricardo Reis, and seminar participants at CREI-Universitat Pompeu Fabra, Banque de France, the 2016 Norges Bank/HEC Montreal/LUISS conference on New Developments in Business Cycle Analysis and the UVa-FRBR Research Jamboree. We gratefully acknowledge financial assistance from the Fondation Banque de France. We thank Jean-Paul Renne for sharing his KfW-Bund spread data and Annemarie Schweinert for excellent research assistance. The views expressed in this paper are those of the authors and do not necessarily reflect those of the Federal Reserve Banks of Richmond and San Francisco or the Federal Reserve System.

†Federal Reserve Bank of San Francisco, CREI, Universitat Pompeu Fabra, CEPR. E-mail: r.barnichon@crei.cat

‡Federal Reserve Bank of Richmond. E-mail: christian.matthes@rich.frb.org

§Universitat Pompeu Fabra. E-mail: alexander.ziegenbein@upf.edu