Incorporating Financial Stability Considerations into a Monetary Policy Framework
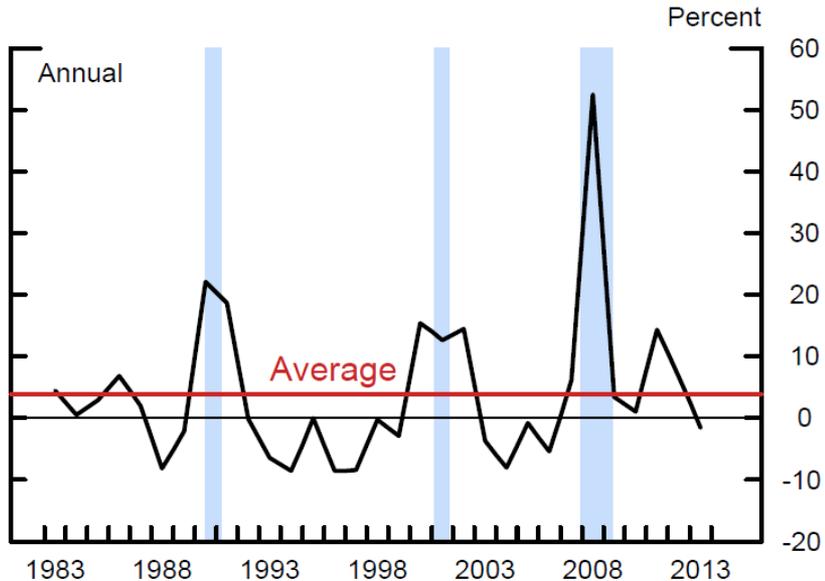
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Federal Reserve Board

April 16, 2014
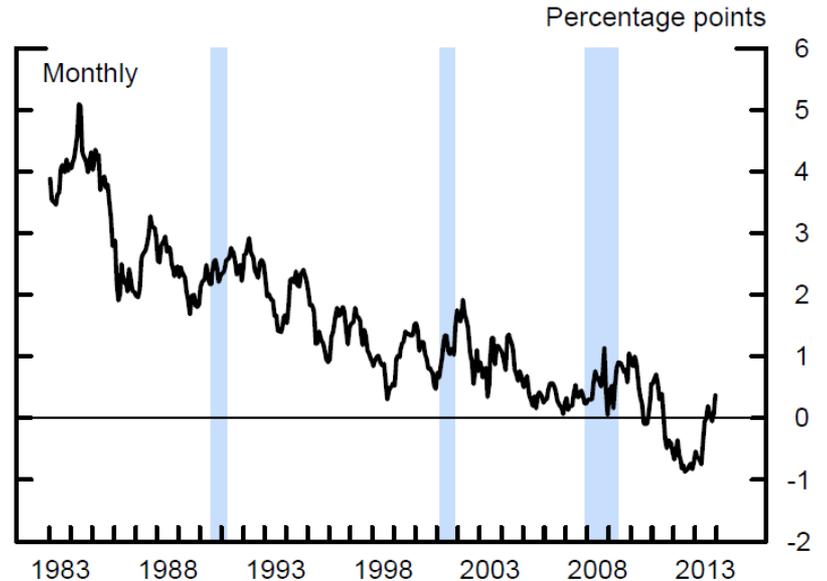
Figure 1

Credit risk premium

Percent

Annual

Average

1983 1988 1993 1998 2003 2008 2013

Note: This figure plots an estimate of the forward-looking credit risk premium, following the approach of Greenwood and Hanson (2013). The estimate is based on the fitted value from a regression of a 2-year-ahead excess return on high-yield bonds (relative to Treasury securities) on the log of the high-yield share and on the Baa credit spread.

Term premium

Percentage points

Monthly

1983 1988 1993 1998 2003 2008 2013

Note: This figure plots an estimate of the 10-year term premium based on the Kim and Wright (2005) latent three-factor Gaussian term structure model.

Figure 2: Excess Bond Premium (EBP), Economic Growth, and the Labor Market
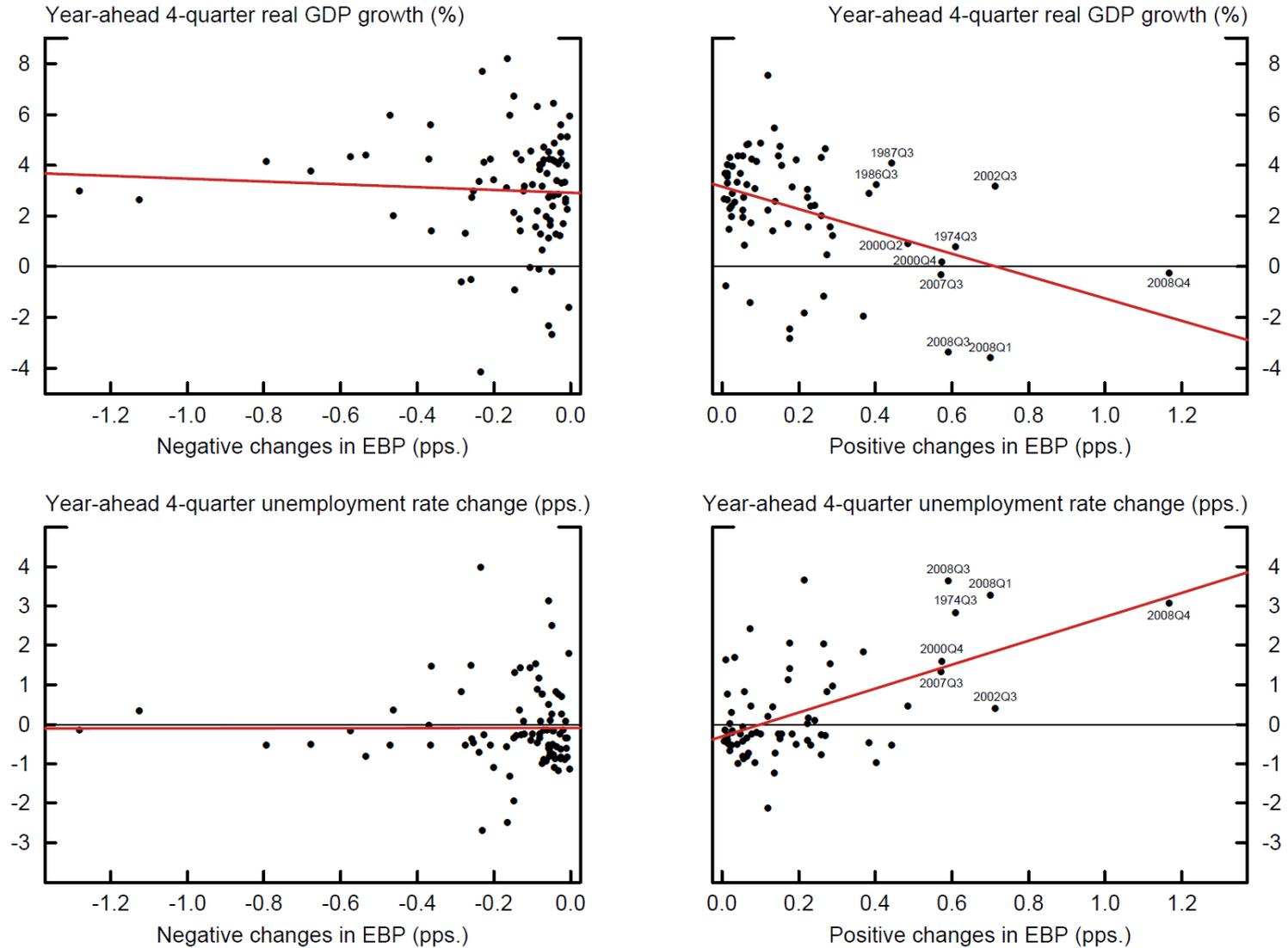
Note: The left (right) chart in the middle panel depicts the relationship between year-ahead 4-quarter real GDP growth and negative (positive) quarterly changes in the EBP in quarter t. The left (right) chart in the bottom panel depicts the relationship between year-ahead 4-quarter change in the unemployment rate and negative (positive) quarterly changes in the EBP in quarter t.

Source: Gilchrist and Zakrajsek (2012) and author calculations based on data from the Bureau of Economic Analysis and the Bureau of Labor Statistics.

Table 1: Asymmetric Effects of Excess Bond Premium on Economic Activity

Explanatory Variables	Real GDP[a]	Unemployment Rate[b]
Increases in the EBP	−4.129***	2.724***
	(1.029)	(0.821)
Decreases in the EBP	−0.261	−0.559
	(0.455)	(0.406)
Real Treasury yield (2y)	0.144	−0.058
	(0.194)	(0.074)
Term spread (10y/2y)	0.488*	−0.446***
	(0.289)	(0.130)
Asymmetry (increase − decrease)	−3.868***	3.283***
	(1.289)	(0.996)
Adj. R^2	0.210	0.303

NOTE: Sample period: 1973:Q1 − 2012:Q4 (Obs. = 154). Entries in the table denote the OLS estimates of the coefficients associated with each financial indicator. Heteroskedasticity- and autocorrelation-consistent asymptotic standard errors are reported in parentheses. Statistical significance at the 10, 5, and 1 percent levels is denoted by *, **, and ***, respectively. In column (a), the dependent variable is the annualized growth rate of real GDP between quarters $t+4$ and $t-1$. In addition to the specified financial indicator in quarter t, each specification also includes a constant and 3 lags of (annualized) quarterly real GDP growth (not reported). In column (b), the dependent variable is the annualized change in the unemployment rate between quarters $t+4$ and $t-1$. In addition to the specified financial indicator in quarter t, each specification also includes a constant and 3 lags of (annualized) quarterly change in the unemployment rate (not reported). SOURCE: Gilchrist and Zakrajsek (2012) and author calculations based on data from the Bureau of Economic Analysis and the Bureau of Labor Statistics.