



Financial Regulation Policy Uncertainty and Credit Spreads in the U.S.

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This paper investigates the linear and nonlinear effects of financial regulation policy uncertainty shocks on U.S. macroeconomic aggregates within a Vector Autoregressive (VAR) framework. Financial regulation policy uncertainty (FRPU) is quantified with a news-based index developed by Baker et al. (2013). Particular attention is paid to the reaction of corporate credit spreads to FRPU shocks. The linear VAR results suggest that exogenous increases in the FRPU index trigger increases in the cost of external finance as well as a persistent negative impact on the real economy. By using a nonlinear (Smooth-Transition) VAR model, I then show that these effects are asymmetric over the business cycle, i.e., credit spreads are estimated to rise three times more during recessions than in non-recessionary periods. Importantly, in both the linear and nonlinear models, FRPU shocks account for large shares of the variability of unemployment and credit spreads. My findings are supported by various robustness checks.