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Macroeconomic risk and asset prices: a tale of two monetary regimes

Abstract

We document significant changes in a broad set of asset prices and macroeconomic dynamics that occurred following the end of the Gold Standard. We show that an aggregate consumption-based asset pricing framework can account for the changes in asset prices, but only when accounting for deviations from log-normality in consumption growth. Our results highlight the importance of changes in quantity of macro risk for asset prices, with potentially large and persistent real effects of monetary policy regimes. We closely match the empirical distribution of consumption growth and uncover a non-Gaussian consumption risk linked to financial cycles, or bad recessions, in terms of frequency and size.