Response of the E.A. Financial Conditions to a shock in U.S. Financial Conditions

- US shocks are much larger than those coming from Euro Area.
- Shocks from Euro Area only have transitory (or very temporary) effects.
- The effects from a US financial shock turn even negative, which suggests of a type of substitution occurring between the two economies.
- Our conclusion regarding US hegemony are solidified with the alternative identification schemes.
- Real shocks generate higher impulse responses, at least on impact.
- The intensity in the transmission of shocks increases over time, at least until the Great Recession when impact of US shocks weakens and negative IRFs disappear.

Cross-border impulse responses: US-to-Euro Area

- Results show that spillovers are not only asymmetric across sectors, but also across economies and time.

Empirical set-up

- Estimation of two dynamic factors per country where weights of each variable in factor is time-varying.
- In parallel, a structural relationship is imposed in the interaction between the two cycles in each period using sign, exclusion, and timing restrictions.
- In the international model, two economies are jointly modeled (including the factors and shocks).
- All autoregressive coefficients and coefficients measuring sensitivity of cycles to shocks can evolve over time.
- Unfortunately, all time variation has been squeezed into the coefficients. Hence the motivation for re-estimating the full model using break in volatility in 1985.

Global results

- Financial cycles are smoother and longer than the macroeconomic [in both economies].
- Private sector liabilities have become increasingly determinant for the shape and evolution of financial cycles.
- Over time, propagation of shocks increased in both directions in EA, but only from financial to real in the US.
- US hegemony in the spillovers between US and EA.
- Deterioration in EA financial or macroeconomic conditions results in a slight improvement in US financial conditions.
- The intensity in the transmission of shocks increases over time, at least until the Great Recession.
- Largest increase in transmission over time was from US financial to EA financial, followed by US real to EA financial.
- Results show that spillovers are not only asymmetric across sectors, but also across economies and time.