



Leibniz-Institut für  
Wirtschaftsforschung Halle

# IWH Research Seminar in Economics

Montag, 6. Juni 2016, 14:15 – 15:45 Uhr, Konferenzsaal im Erdgeschoss



## Monetary Policy and Asset Mispricing

Professor Dr. Kerstin Bernoth, DIW Berlin

This paper investigates, whether conventional interest rate policy of central banks is a suitable instrument to attenuate excessive mispricing in stocks as suggested by the proponents of a "leaning against the wind" (LATW) monetary policy. We argue mispricing can arise for two reasons: (i) from false subjective expectations of investors about future fundamentals and equity premia, and (ii) from the inherent indeterminacy in asset pricing in line with rational bubbles under objective expectations. Employing a partial equilibrium asset pricing model, we show that the response of the excessive stock price component to a monetary policy shock is ambiguous in both the short- and long-run and depends on the nature of the mispricing. Subsequently, we evaluate the scope for a LATW policy empirically by employing a time-varying parameter VAR with a flexible identification scheme based on impact and long-run restrictions using data for the S&P500 index from 1962Q1 to 2014Q4. We find that a contractionary monetary policy shock in fact lowers stock prices beyond what is implied by the response of their underlying fundamentals.

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