

Financial Stability Monitoring

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Abstract

We present a forward-looking monitoring program to identify and track the sources of systemic risk over time and to facilitate the development of pre-emptive policies to promote financial stability. We offer a framework that distinguishes between shocks, which are difficult to prevent, and vulnerabilities that amplify shocks. Building on substantial research, we focus on leverage, maturity transformation, interconnectedness, complexity, and the pricing of risk as the primary vulnerabilities in the financial system. The monitoring program tracks these vulnerabilities in four areas: the banking sector, shadow banking, asset markets, and the nonfinancial sector. The framework also highlights the policy trade-off between reducing systemic risk and raising the cost of financial intermediation by taking pre-emptive actions to reduce vulnerabilities.

Key words: financial stability, systemic risk

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