



# Dynamic Interactions Between Financial and Macroeconomic Imbalances: A Panel VAR Analysis

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# Abstract

We use Bayesian and GMM panel VAR frameworks to study interactions between financial cycles and macroeconomic imbalances based on a global sample of 24 countries spanning the period 1998–2012. We find that financial cycles play an important role in shaping macroeconomic imbalances with expansions inducing economic overheating and a downward pressure on public debt-to-GDP ratios, and vice versa. Bank-based economies exhibit a deeper and faster response of business cycles to financial misalignments, while the impact in market-based economies is milder, but more persistent, as well as more significant for current account and public debt dynamics. Financial cycles invoke a particularly strong reaction of current account balances and especially public debt ratios in the euro area.

**Keywords:** financial cycles, macroeconomic imbalances, financial stability, business cycles, panel VAR, Bayesian VAR

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