

[The Transmission of Macroprudential Policy in the Tails: Evidence from a Narrative Approach](#)

CFM-DP2026-11

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A key aim of macroprudential policy is to reduce ‘tail risks’—i.e., minimise the potential economic costs of negative shocks by bolstering the resilience of the financial sector. However, building this resilience may not always be costless. To gauge these costs and benefits, it is important to attain accurate estimates of the causal effects of macroprudential policy on the *entire distribution* of potential macroeconomic outcomes.

We estimate the effects of macroprudential policies on the entire distribution of GDP growth and explore its transmission channels. We do so by constructing a macroprudential policy index using a dataset covering a range of policy actions across advanced European economies. The policy actions include, amongst other things, a range of capital and liquidity-based measures. Using rich narrative information available in the dataset—including announcement and enforcement dates and whether policies have a countercyclical design—we identify macroprudential ‘shocks’ that are both unanticipated by agents and exogenous to the state of the macroeconomy. We then estimate the relationship between these macroprudential-policy shocks and the entire distribution of the GDP distribution, as well as explore various transmission channels. We estimate quantile-regression local projections to study the response of different quantiles of GDP growth across horizons to our shock. And then repeat this exercise using different left hand side variables, to look at the effect on intermediate outcomes such as credit growth and asset prices to thus unpick the transmission mechanisms of macroprudential policy.

We find that tighter macroprudential policy significantly boosts the left tail of future GDP growth (i.e., reduces the probability and severity of ‘bad’ GDP outturns), while simultaneously reducing the right tail of GDP growth. Together, these effects serve to reduce the variance of future growth. The effects on average growth are muted, and generally insignificant.

We then consider the channels through which macroprudential policies affect the GDP-growth distribution. We find that macroprudential policy is particularly effective at reducing the right tail of credit growth (i.e., reducing the probability of excessive credit ‘booms’). In turn, we find the prevention of credit booms serves to reduce downside risks to GDP growth significantly. We find limited evidence for other transmission channels: macroprudential policy does not significantly influence the composition of credit (between households and businesses) or transmit via asset-price channels (e.g., financial conditions, house prices).