Review Article
Volume 13:8, 2022

Business and Economics Journal

ISSN: 2151-6219 Open Access

Macro-Financial Linkages and the Financial System

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Abstract

The IMF's duty to oversee the stability of the global financial system has long been centred on macro financial linkages. With the onset of the financial crisis, the Fund has used this research to add to vital discussions on the types of suitable national and international policy responses. Since few collections have been published in this field, the current time is a wonderful chance to evaluate this body of work by IMF personnel and to share it with a wider audience. The best literature by IMF economists on macroeconomic issues is collected in this volume, which also emphasises the ideas and methods that have shaped IMF thought in the field as a whole. The book's chapters fall into one of three categories: macroeconomic policy, business and financial sector challenges, including domestic and international financial liberalisation; financial crises and boom-bust cycles; financial integration, financial liberalisation, and economic performance. With the emergence of new theories about how monetary policy affects real economic activities over the past few years, there have been significant changes in the way the financial system operates and how monetary policy is carried out, which have advanced our understanding of the macro financial linkages.

Keywords: Macro-Financial • Financial system • Financial stability

Introduction

The onset of the most recent global financial crisis has revealed more complicated and deep linkages in the monetary policy transmission mechanism. As a result, central bankers and policy analysts are starting to pay more attention to the entire financial system as well as how it interacts with the real economy rather than just the traditional monetary system. According to empirical research, monetary authorities should consider financial market disturbances when determining their monetary policy. However, there are worries that it would make the procedures for inflation targeting more difficult. A monetary authority's response to asset price movements is also viewed as an extended purpose for monetary policy. It is stated that monetary policy is a tool for macroeconomic policy that should be employed for macroeconomic goals rather than for a particular market or regional occurrences, as in the financial market. However, asset price changes may result in significant debt accumulations, weakening balance sheets, and financial imbalances, which can produce financial instability and, in turn, macroeconomic volatility, as argued by proponents of central bank involvement (in case of a financial crisis).

Description

As more recent bouts of the global financial crisis have been exacerbated by growing trade and financial integration, the roles of central banks are also crucial for the maintenance of financial stability. Adapting to these more recent issues. The macroeconomic Interlink age implies that there may be both a direction and a causal relationship. There is a feedback loop, for example. Additionally, recently there have there has been a lot of debate about the best monetary policy. choosen in the wake of a financial catastrophe. That implies that there. Monetary policy and financial stability do have a relationship, however. There is still no agreement on how one influences the other. There is a claim that the Stock market crashes are not the primary issue monetary policymakers must address. A deeper understanding of the connections between the macro economy and financial sector is necessary in light of the extensive repercussions of the global financial crisis of 2008–2009 in the advanced countries and subsequently its spill over effects on the emerging market economies (EMEs). For improving the accuracy of macroeconomic forecasts, selecting the best policy tools for intervention, and developing the fiscal, monetary, and financial policies, it is crucial to understand the type and extent of these links. As a result, researchers have started to look at the connections between credit, asset values, and economic activity using various methodologies [1-2].

The crisis reignited a long-running argument in the field of economics concerning the significance of macro financial links. Some contend that the crisis served as a sobering reminder of how little we actually know about these connections. Others assert that although the profession has made significant strides in comprehending them, too much emphasis was placed on specific techniques and modelling options. However, the majority also acknowledge that the lack of a unified framework to examine these two-way interactions has constrained the application of current knowledge in real-world settings and hampered the development of policy. In light of these findings, this paper offers a systematic analysis of the rapidly growing body of research on macro financial relationships. It begins by reviewing the research on the connections between asset prices and macroeconomic results. The literature on the effects of financial flaws on macroeconomics is then reviewed. The essential stylized facts concerning the connections between the financial sector and the actual economy are also covered, along with the worldwide implications of macro financial linkages. Given the numerous unanswered problems and substantial interest from the policy community, the study of macro financial links is likely to remain a fascinating field of inquiry. The report continues with a discussion of potential avenues for future research, highlighting the need for more robust empirical work, richer theoretical models, and better data in order to increase understanding and aid in guiding policymakers moving forward [3-5].

Conclusion

According to empirical data based on the knowledge of advanced nations, financial cycles precede business cycles. It is unclear, however, if this pattern remains true for the EMEs due to a lack of evidence. A priori, it is not clear if an economy like India's financial health is a leading or trailing predictor of actual economic activity. Furthermore, the quantitative

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Date of Submission: 02-Aug-2022, Manuscript No. bej-22-77813; **Editor Assigned:** 04-Aug-2022, PreQC No. P-77813; **Reviewed:** 15-Aug-2022, QC No. Q-77813; **Revised:** 20-Aug-2022, Manuscript No. R-77813; **Published:** 25-Aug-2022, DOI: 10.37421/2151-6219.2022.13.395

significance of the connection variables and the operation of the feedback mechanism between the financial sector and the state of the macro economy are not well understood. To this purpose, our research presents evidence of macro-financial links from the Indian economy that is country-specific. This essay makes two contributions to the on-going discussion on the connections between the macro economy and the financial sector. Due to the growing scale of the credit, equity, insurance, and debt markets as well as the expansion of the potential interface with real economic variables, the Indian financial sector has experienced fast growth over the past 25 years. However, because this expansion is not dispersed equally among the market segments, the interactions between the various market segments on the actual side are more complicated. In this paper, we evaluate the heterogeneities in the macro-financial connections with a theoretically informed empirical methodology, drawing data from the real-financial interactions. We first give the empirical regularities on the interactions between the economic activities and volume of turnover in the financial sector using the sample period 2004: Q3 to 2019: Q1, and then we provide a conceptually sound analysis.

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How to cite this article: Wang, Yachao. “Macro-Financial Linkages and the Financial System.” Bus Econ J 13 (2022): 396.