

Discussion of Bauer, Schmeling, and Schrimpf's “Risk Appetite and Monetary Transmission”

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¹ The views here are not official positions of the Chicago Fed or the Federal Reserve System.

Overview

Paper provides evidence that changes in risk attitudes around FOMC announcements—not changes in interest rates—are the dominant channel for monetary-policy shocks.

This is potentially a very important result.

- Our core macroeconomic models disregard the role of risk.
- In workhorse NK model, monetary transmission operates through intertemporal substitution, which depends only on the path of risk-free rates.
- Paper implies that this literature misses the key facts.
- Supports models that involve some kind of risk-taking channel (though this is nuanced).

Discussion Outline

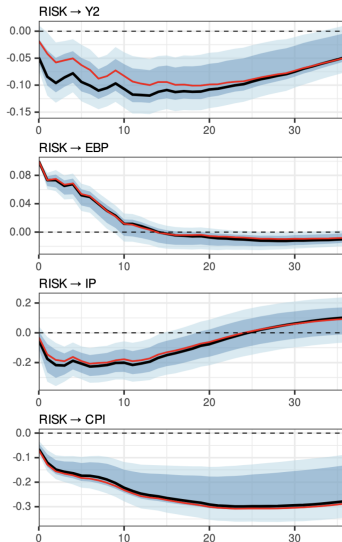
- Brief review of methodology and results
- Two questions about interpretation:
 - 1 What exactly *is* the transmission mechanism?
 - 2 Risk appetite or just risk?

Summary of BSS Approach

- ① Standard high-freq. event-study methodology to identify monetary-policy shocks.
- ② Careful measurement of RISK factor:
 - Follows Bernanke, Bauer, & Milstein (*JEP*, 2023)
 - Intraday window around FOMC announcements
 - First principal component of 11 risk metrics
 - (Although this only explains 56% of variation. What about the rest?)
 - Allow RISK to be correlated with conventional policy shocks.
- ③ Use MP and RISK shocks as external instruments in VAR.
 - Mertens and Ravn (2013) for 2-instrument/2-variable setup.

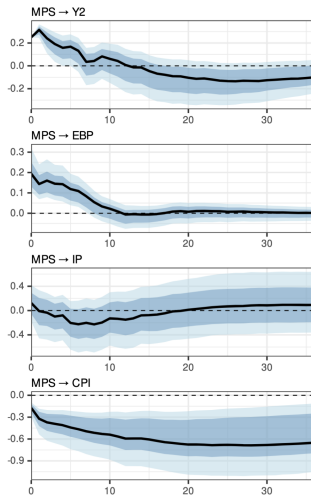
Main Results

RISK shocks have significant macro effects:

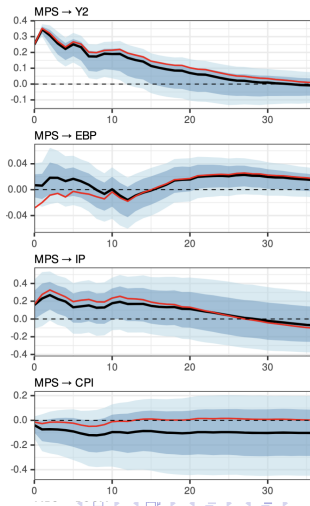


Main Results

Controlling for RISK shocks, MP shocks have *no* macro effects:
1 instrument



2 instruments



Question 1: What exactly is the mechanism?

Authors' interpretation: “Fed policy actions and communications have substantial effects on risk appetite, consistent with the literature on the *risk-taking channel* of monetary policy.”

- They cite several theory papers that feature a risk-taking channel.
- But in these models, risk appetite changes *because* of a change in rates.
- If this were the main transmission channel, we would expect MPS to (1) explain a large fraction of RISK, (2) have a big effect on EBP, and (3) lead to significant macro effects.
- Instead, they find MPS (1) explains only 19% of RISK, (2) has no significant effect on EBP, and (3) has no significant macro effects.
- So this seems like evidence *against* the risk-taking channel!

So then, what *is* the explanation?

Authors offer two stories:

1. Risk-taking mechanisms are nonlinear and state-dependent:

State variable S_{t-1}	Q1 (lower 25%)		Q4 (upper 25%)	
	$\hat{\beta}(t)$	R^2	$\hat{\beta}(t)$	R^2
Intermediary capital ratio (detrended)	0.29** (2.08)	0.13	1.07*** (6.43)	0.51

- But this is awkward—implies their VAR identification is mis-specified.
- Some of the apparent effects of their RISK shocks are really MPS in disguise.
- Is it possible to improve this with a nonlinear IV?

And, even in their nonlinear models, R^2 s are at most around 50%, so there is still something else going on.

So then, what *is* the explanation?

2. Effects of communication beyond expected rate path

- “Change perceptions of balance of risks and uncertainty” or “take certain tail risks off the table.”
- “Changes in the perceived reaction function also shift the balance of risks.”
- Revealed disagreement between FOMC and markets may cause “markets to price in future ‘policy errors’.”

Are these really changes in risk appetite, or just in the quantity of risk?

Question 2: Risk appetite or just *risk*?

“We interpret RISK as a measure of policy-driven shifts in risk appetite, i.e., changes in the **willingness of the marginal investor to bear risk**, but our conclusions are also consistent with a broader interpretation as a risk premium factor that includes changes in **perceived quantities of risk**.”

- Is there any reason to favor this interpretation?
- The distinction matters both for distinguishing among theories and for designing effective policy / communication.
- Easier to think of stories where rate uncertainty changes independently of rate expectations.

Question 2: Risk appetite or just *risk*?

One defense of the “risk appetite” interpretation:

“... changes in the quantity of risk are asset-specific and are unlikely to drive much of the common variation in risk.”

- But common factor would need to account for only $56\% \times 0.81 = 46\%$ of the variance in risk premia in a narrow window.
- We know that there are common risks across asset classes, so this seems plausible.

Some evidence for changes in risk perceptions

Narrative evidence about RISK shocks often sounds like shocks to the perceived quantity of risk...

- 2001-03-20 “failed to restore confidence”
- 2001-09-17 “the market hates uncertainty”
- 2007-09-18 “drained fear from the market”
- 2007-12-11 “fear jumped”
- 2008-12-16 “restored confidence”
- 2015-03-18 “eased fear”
- 2020-03-03 “fed fear”
- 2021-12-15 “resolved a large overhang of policy uncertainty”
- 2022-05-04 “removing the tail risks markets feared”
- 2024-12-18 “injected new uncertainty”

Some more evidence for changes in risk perceptions

There is other evidence that uncertainty about the reaction function drives asset prices around FOMC meetings.

- “Monetary-policy risk” (MPR)

Updating Bauer, Lakdawala, & Mueller (*EJ*, 2022)...

	5Y nom. yield	10Y nom. yield	5Y real yield	10Y real yield	SPX	VIX	MOVE
Monetary-policy shock	0.40*** (0.07)	0.19*** (0.07)	0.63*** (0.11)	0.38*** (0.10)	-2.80** (1.25)	1.10 (1.80)	-0.04 (0.04)
Short-rate uncertainty (MPR)	0.87*** (0.16)	0.87*** (0.15)	1.55*** (0.20)	1.30*** (0.10)	-8.54*** (2.78)	20.6*** (4.10)	0.69*** (0.09)
Adj. R^2	0.29	0.20	0.40	0.31	0.07	0.11	0.20
# obs.	243	243	170	170	244	244	240

Source: Feldman & King (2026), following Bauer et al. (2022)

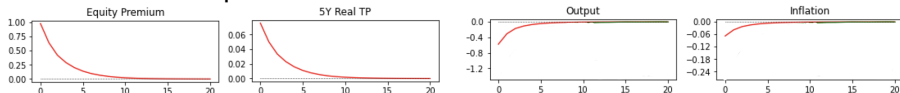
What do MPR shocks do in a model?

1. Match empirical responses of asset prices

B. Response to MPR shock on impact, holding 1-year short rate constant

	5y nom. yield (bps)	5y real yield (bps)	10y nom. yield (bps)	10y real yield (bps)	Stock return (%)	VIX (ann. %)	MOVE (ann. bps)
Data	+69 (17)	+121 (25)	+65 (16)	+98 (23)	-4.7 (2.9)	+14.5 (4.3)	+67 (10)
Model	+42	+104	+21	+53	-8.7	+13.2	+100

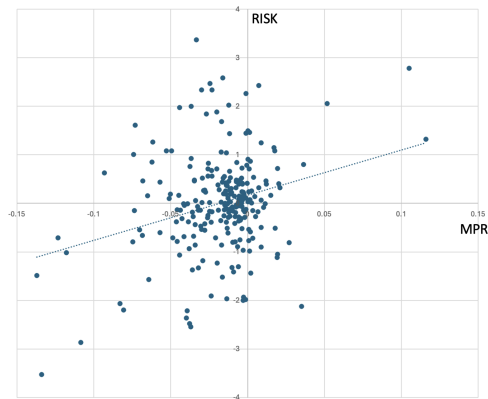
2. Effects on risk premia and macro variables similar to RISK



Source: Feldman & King (2026)

Comparing RISK to MPR

- MPR explains some of RISK.
- Nonlinear/state-depedent effects here too.
- Also maybe depends on uncertainty horizon.



Summing up

- Important and provocative paper with careful empirical work.
- Firming up the interpretation would make the theoretical and policy implications clearer.
 - whether they really are capturing *risk* or risk *appetite*;
 - if appetite, then what is the channel?
- Future research should try to connect more precisely with particular theoretical models.