Report paper MS 866

The real versus the financial economy: “A global tale of stability versus volatility” by Philipp Mundty Niels Förstery Simone Alfarano Mishael Milakovic´

The paper is interesting and timely and this reviewer recommends its publication.

As mentioned by the authors Shiller had already observed that the arrival of economic news cannot justify the volatility found in financial market. Therefore explanations for market volatility cannot be found in the objective fluctuations of the real economy. However the fact that financial and real investments offer the same returns in the long run has never been clearly established on large data bases.

The paper contributes an interesting empirical analysis which shows that in the long run the average return to real investments is approximately the same as the average return to purely financial investments but the latter is subject to much larger fluctuations. This result is interesting in itself and it confirms that in the long run excess financial returns are not sustainable. As the authors use a large data base their conclusions are solid and credible.

Their analysis could be improved in several ways. First, given the vast size of their empirical data base, they should analyze the relationship of corporate profits with the growth of GNP of the relevant economies. Second, they should analyze more in depth the relationship between risk and returns. Their result shows that in the long run the usual assumptions on risk remuneration are not respected, a fact that deserves analysis. Finally, they seem to ignore the process of money generation and the banking system. Much of the volatility of financial markets come from the availability of money.

This being said, this reviewer confirms that it is a nice contribution that warrants publication.