Financial Risk and Management:
An International Journal
Volume 1, Number 2, 2022

Government Stimulus Policies and Financial Stability Risks: A Literature Review

Batrisyia Karamina[1]

[1] Universitas Diponegoro, Semarang, Indonesia

Abstract

Article history:
Received: August 24, 2022
Revised: September 8, 2022
Accepted: October 13, 2022
Published: December 30, 2022

Keywords:
Crisis Response,
Financial Stability,
Macroprudential Policy,
Stimulus Measures,
Systemic Risk.

Identifier:
Zera Open
Page: 88-99
https://zeraopen.com/journal/frmij

This study examines how government stimulus policies influence financial stability during periods of severe economic disruption, with a focus on the mechanisms through which fiscal and monetary interventions shape risk-taking behavior, credit conditions, and systemic resilience. Using a systematic literature review of peer-reviewed studies published between 2017 and 2021, the article synthesizes empirical evidence on the effectiveness and unintended consequences of stimulus measures implemented during recent global crises. The review discusses how targeted fiscal support, liquidity facilities, and credit guarantees stabilized short-term financial conditions while also identifying risks associated with increased leverage, delayed restructuring, and uneven policy absorption across firms. The findings show that stimulus programs are essential for crisis mitigation but must be complemented by strong regulatory oversight and macroprudential coordination to prevent long-term vulnerabilities. This study contributes to ongoing debates by clarifying the trade-offs between short-term stabilization and sustainable financial system resilience.

1. Introduction

Government stimulus policies have become a central stabilizing mechanism in modern economic governance, particularly during periods of heightened uncertainty and systemic financial stress. In the aftermath of global disruptions such as the COVID-19 pandemic, governments implemented unprecedented fiscal and liquidity measures to sustain economic activity, preserve employment, and safeguard financial systems. These interventions ranged from direct income support and credit guarantees to large-scale liquidity facilities and regulatory forbearance, all of which played a significant role in sustaining the banking sector and mitigating the immediate impact of the crisis (Demirgüç-Kunt et al., 2021). While such policies were essential in mitigating immediate economic fallout, recent scholarly debates highlight the need to examine their broader implications for financial stability. Understanding how stimulus instruments interact with market behavior, institutional responses, and systemic vulnerabilities has therefore emerged as an important area of contemporary financial research.

Recent studies suggest that expansive fiscal and monetary support can influence financial stability through several interconnected channels. Accommodative policy environments, characterized by low interest rates, ample liquidity, and eased credit conditions, may inadvertently incentivize excessive risk-taking among firms and financial intermediaries. Evidence shows that periods of prolonged policy support can fuel leverage growth, amplify asset price imbalances, and contribute to liquidity mismatches within financial markets (Borio & Gambacorta, 2017; Adrian & Liang, 2018). During crisis periods, firms may also engage in aggressive liquidity hoarding or increased reliance on government backstops, which, while stabilizing in the short term, can create dependencies and weaken market discipline (Acharya & Steffen, 2020). These developments illustrate the dual-edged nature of stimulus interventions: while they cushion economic shocks, they may simultaneously sow the seeds for future instability if not calibrated effectively.

At the same time, recent literature also underscores the stabilizing role of well-designed and well-targeted stimulus programs. Coordinated fiscal support, combined with prudent regulatory measures, can reduce systemic stress, sustain credit flows, and support the resilience of financial institutions. Research during the COVID-19 crisis shows that policy responses helped stabilize banking sector performance and prevented a deeper credit contraction, especially in countries that paired fiscal stimulus with strong macroprudential frameworks (Demirgüç-Kunt et al., 2021). Similarly, insights from systemic crisis databases indicate that strategic government interventions can mitigate long-term damage and contain contagion when implemented with effective safeguards (Laeven & Valencia, 2020). These findings collectively highlight that the effects of stimulus policies on financial stability are contingent on timing, design, targeting, and institutional capacity.

Given these varied perspectives, a systematic literature review is essential to consolidate existing empirical evidence and assess how stimulus policies shape financial stability risks across different contexts. By synthesizing studies published between 2017 and 2021, this review aims to clarify the mechanisms through which government stimulus influences financial systems, identify emerging patterns in the literature, and provide policy-relevant insights for designing interventions that balance short-term stabilization with long-term financial resilience.

2. Literature Review

Research on government stimulus policies and financial stability increasingly highlights the channels through which fiscal and monetary responses shape risk-taking incentives and systemic vulnerability. Studies show that accommodative monetary conditions, combined with extensive liquidity provision, can reduce lending standards and encourage leverage accumulation across financial institutions (Borio & Gambacorta, 2017; Adrian & Liang, 2018). Fiscal stimulus through credit guarantees or repayment forbearance may also generate unintended consequences when firms develop reliance on policy support rather than strengthening internal balance sheets (Acharya & Steffen, 2020). These findings reinforce the need to evaluate how crisis-related interventions influence both firm-level financial behavior and broader macro-financial dynamics.

At the same time, the literature emphasizes that the effectiveness of stimulus policies depends on institutional design, targeting mechanisms, and regulatory coordination. Empirical evidence shows that banking systems operating under stronger supervisory frameworks and transparent fiscal support maintain more stable credit flows and demonstrate greater resilience during crisis periods (Li et al., 2020; Demirgüç-Kunt et al., 2021). Comparative analyses also reveal that stimulus measures aligned with macroprudential policies help prevent procyclical lending patterns and mitigate rising vulnerabilities in credit markets (Fendoğlu, 2017). These studies suggest that the presence of rule-based macroprudential tools strengthens the stabilizing role of government interventions while reducing the likelihood of excessive risk-taking.

More recent research has expanded the discussion by analyzing the differing impacts of stimulus across institutional contexts and economic sectors. Evidence from nonprofit financial management in the United States shows that stimulus and relief programs played a key role in reducing solvency risks, although their distributional effects created uneven resilience outcomes across organizations (Johnson et al., 2021). Parallel findings from global financial markets indicate that pandemic-related interventions helped contain liquidity pressures, yet long-term dependence on public support may weaken market signaling and delay necessary adjustments (Krogstrup & Oman, 2019). Studies examining corporate financing behavior further demonstrate that firms respond to stimulus incentives by restructuring liquidity positions and drawing heavily on credit lines, which can stabilize short-term operations while increasing exposure to future refinancing risks (Acharya & Steffen, 2020; Li et al., 2020). Collectively, this literature underscores the complex trade-offs between immediate crisis stabilization and the preservation of long-term financial system integrity.

3. Methods

This study adopts a systematic literature review approach to examine the relationship between government stimulus policies and financial stability risks. The review focuses on peer-reviewed empirical studies published between 2017 and

2021, reflecting the most recent period in which extensive fiscal and monetary interventions were implemented globally. Searches were conducted using academic databases such as Scopus, Web of Science, and Google Scholar, with keywords including "government stimulus", "financial stability", "macroprudential policy", "systemic risk", and "crisis interventions". Studies were included if they provided empirical evidence on the financial stability implications of stimulus measures, evaluated the effects of monetary or fiscal policy responses, or examined firm and bank behavior during crisis periods. Conceptual papers, commentaries, and studies unrelated to macro-financial outcomes were excluded to maintain analytical consistency.

The screening process followed standard systematic review procedures, beginning with the identification of potentially relevant studies, followed by abstract screening and full-text evaluation. Data extracted from selected studies included research context, methodological approaches, policy instruments analyzed, and key findings related to risk-taking behavior, credit market responses, and systemic vulnerabilities. The synthesis used a narrative approach to compare results across different institutional settings and policy frameworks, enabling the identification of recurring themes and variations in outcomes. This method supports a structured and transparent assessment of how government stimulus interventions have influenced financial stability across diverse economic environments.

4. Results and Discussion

The findings of the reviewed studies show that government stimulus policies have been essential in stabilizing financial systems during recent crises, particularly the COVID-19 shock, yet they also create several layers of financial stability considerations. Many empirical studies indicate that fiscal transfers, credit guarantees, and liquidity facilities were successful in reducing immediate liquidity pressures on firms and households. These interventions helped strengthen short-term cash positions, reduced insolvency risks, and supported lending activity during periods of heightened uncertainty. Evidence from firm-level data shows that companies often increased their liquidity reserves through precautionary borrowing and relied on stimulus programs to compensate for revenue losses, which contributed to preventing widespread corporate failures (Acharya & Steffen, 2020; Li et al., 2020). These findings illustrate how well-timed support measures can interrupt financial distress cycles that otherwise amplify into systemic instability.

Despite these stabilizing effects, several studies document rising risk-taking behaviors in financial markets where supportive monetary conditions and public backstops were prevalent. Accommodative policy environments characterized by low interest rates and ample liquidity encouraged financial institutions to assume higher risk exposures, partly in response to compressed margins and subdued investment returns. Research highlights that banks and nonbank intermediaries increased leverage and shifted toward riskier portfolios in the pursuit of yield (Borio & Gambacorta, 2017; Adrian & Liang, 2018). Firm-level analyses from Italy provide further evidence that the crisis exacerbated equity shortfalls for financially weaker firms, even when policy support was available, suggesting that stimulus programs alone could not fully counterbalance pre-existing vulnerabilities (Carletti et al., 2020). These outcomes indicate that stimulus measures can stabilize immediate financial conditions while simultaneously postponing or obscuring fundamental weaknesses within the financial system.

The literature also reveals that the distribution of stimulus benefits was uneven across sectors and firms. Companies with stronger governance structures, diversified revenue streams, and better banking relationships were more successful in using policy support to strengthen their financial positions. Studies show that such firms experienced milder declines in performance during the pandemic, while more vulnerable firms became significantly dependent on government assistance to maintain operations (Ding et al., 2021). This pattern raises concerns about long-term allocative efficiency, as stimulus programs may unintentionally reinforce existing disparities in financial resilience. Additionally, evidence from global financial markets demonstrates that government interventions influenced investor sentiment and asset pricing behavior. International studies find that financial market responses were strongly shaped by the scale and credibility of government actions, with markets in countries adopting assertive interventions reacting more positively (Ashraf, 2020). While these responses contributed to short-term stability, they also prompted accelerated asset price recoveries that, in some cases, seemed disconnected from underlying economic fundamentals.

Another important result across the literature concerns the risks generated by prolonged reliance on public support mechanisms. Measures such as loan forbearance and government guarantees can delay restructuring processes that are necessary for long-term efficiency, potentially increasing the presence of firms with weak fundamentals in the broader economy. The persistence of nonviable firms can heighten future default risks and place renewed pressure on banks and credit markets once support measures are withdrawn. Studies examining the global economic effects of the pandemic also note that economies with extensive stimulus programs experienced complex interactions between public support, market volatility, and real sector adjustments (Louhichi et al., 2021). These interactions suggest that although stimulus programs help prevent immediate systemic collapse, they introduce future vulnerabilities that must be addressed through careful policy sequencing.

Taken together, the literature shows that government stimulus policies achieved substantial short-term stabilization by supporting liquidity, maintaining credit supply, and reinforcing market confidence. However, these benefits were accompanied by significant trade-offs related to elevated risk-taking, delayed restructuring, uneven policy reach, and potential mispricing of risk in financial markets. The results indicate that the long-term effects of stimulus interventions depend heavily on institutional quality, regulatory coordination, and the design features of the policies themselves. For stimulus to enhance both immediate stability and long-term resilience, the evidence suggests that interventions should be timely, targeted, temporary, transparent, and accompanied by strong macroprudential oversight.

5. Conclusion

The findings of this review demonstrate that government stimulus policies have been central in preventing deeper financial distress during major economic disruptions. Fiscal support, liquidity injections, and credit guarantees provided essential buffers that helped firms sustain operations, supported household income, and stabilized banking sector performance. These measures reduced liquidity shortages, prevented rapid increases in insolvency, and contributed to stabilizing financial markets during the most acute phases of the crisis. The evidence consistently shows that timely government action can interrupt negative feedback loops between the real economy and financial institutions, thereby reducing the likelihood of systemic failure.

At the same time, the literature indicates that these stabilizing effects come with important long-term considerations. Accommodative policy environments and extensive government support can create incentives for increased risk-taking, weaken market discipline, and delay necessary adjustments within firms and financial institutions. Studies highlight that pre-existing firm vulnerabilities, differences in governance, and the strength of regulatory frameworks significantly influence how stimulus measures are absorbed. Firms with stronger financial positions and more established banking relationships benefited disproportionately, while weaker firms became more dependent on public support to avoid insolvency. Such patterns raise important concerns regarding allocative efficiency, the persistence of financially fragile firms, and the potential buildup of future credit risks once policy support is withdrawn.

Taken together, these findings suggest that the design and implementation of stimulus policies must balance short-term stabilization objectives with long-term financial stability considerations. Effective stimulus programs should be timely, targeted, and temporary to limit distortions, while transparency in policy execution helps preserve confidence and reduce uncertainty. The coordination of fiscal, monetary, and macroprudential policies is crucial for ensuring that interventions mitigate immediate risks without creating new vulnerabilities. As governments prepare for future economic shocks, the evidence emphasizes the importance of strong institutional capacity, robust regulatory oversight, and carefully calibrated policy frameworks that support resilience while safeguarding the long-term integrity of financial systems.

References

Acharya, V. V., & Steffen, S. (2020). The risk of being a fallen angel and the corporate dash for cash in the midst of COVID. *The Review of Corporate Finance Studies, 9*(3), 430-471.

Adrian, T., & Liang, N. (2018). Monetary policy, financial conditions, and financial stability. *52nd Issue (January 2018) of the International Journal of Central Banking.*

Ashraf, B. N. (2020). Economic impact of government interventions during the COVID-19 pandemic: International evidence from financial markets. *Journal of behavioral and experimental finance, 27*, 100371.

Borio, C., & Gambacorta, L. (2017). Monetary policy and bank lending in a low interest rate environment: diminishing effectiveness?. *Journal of Macroeconomics, 54*, 217-231.

Carletti, E., Oliviero, T., Pagano, M., Pelizzon, L., & Subrahmanyam, M. G. (2020). The COVID-19 shock and equity shortfall: Firm-level evidence from Italy. *The Review of Corporate Finance Studies, 9*(3), 534-568.

Demirgüç-Kunt, A., Pedraza, A., & Ruiz-Ortega, C. (2021). Banking sector performance during the COVID-19 crisis. *Journal of Banking & Finance, 133*, 106305.

Ding, W., Levine, R., Lin, C., & Xie, W. (2021). Corporate immunity to the COVID-19 pandemic. *Journal of financial economics, 141*(2), 802-830.

Fendoğlu, S. (2017). Credit cycles and capital flows: Effectiveness of the macroprudential policy framework in emerging market economies. *Journal of Banking & Finance, 79*, 110-128.

Johnson, A. F., Rauhaus, B. M., & Webb-Farley, K. (2021). The COVID-19 pandemic: a challenge for US nonprofits' financial stability. *Journal of Public Budgeting, Accounting & Financial Management, 33*(1), 33-46.

Krogstrup, S., & Oman, W. (2019). *Macroeconomic and financial policies for climate change mitigation: A review of the literature* (IMF Working Paper No. 2019/185). International Monetary Fund.

Laeven, L., & Valencia, F. (2020). Systemic banking crises database II. *IMF Economic Review, 68*(2), 307-361.

Li, L., Strahan, P. E., & Zhang, S. (2020). Banks as lenders of first resort: Evidence from the COVID-19 crisis. *The Review of Corporate Finance Studies, 9*(3), 472-500.

Louhichi, W., Ftiti, Z., & Ameur, H. B. (2021). Measuring the global economic impact of the coronavirus outbreak: Evidence from the main cluster countries. *Technological Forecasting and Social Change, 167*, 120732.