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ACCEPTED MANUSCRIPT

Open Market Operations*

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Abstract

In an open market operation, the central bank swaps currency for bonds. We show how injecting money in this way is different from transfers, the way policy is usually formulated. The model captures liquidity explicitly by modeling the roles of assets in frictional exchange. Under various specifications for market structure and the acceptability or pledgeability of assets, we discuss implications for the Fisher and quantity equations, the possibility of negative nominal yields, liquidity traps, and market segmentation. When liquidity is endogenized using information theory, multiple equilibria emerge, with different policy predictions. Interest on reserves and quantitative easing are discussed.

JEL Classification Numbers: E4, E5
Key Words: Monetary Policy, Interest Rates, Inflation

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