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Monetary Policy and the Twin Crises

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Abstract. After presenting a brief overview of the recent financial crisis and the European debt crisis that followed in its wake, this paper goes on to discuss monetary policy in the United States, the United Kingdom and the Euro bloc prior to and during the course of the two crises. The paper presents historical evidence for the three areas on the relationships linking the volatilities of output, inflation and monetary growth. In all three these relations are strongly positive. There is, therefore, no tradeoff between inflation and output volatility; the two move up and down together. Both, moreover, move up and down with the volatility of monetary growth. Viewed from this perspective, the increased volatilities of money supplies and the monetary base in the United States, the United Kingdom and the Euro bloc over the last half decade pose problems.

JEL Classification: E32, E4, E5

Keywords: Monetary policy, money multiplier, financial crisis, European debt crisis

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