Accepted Manuscript

Title: Monetary policy and financial stability in the long run: A simple game-theoretic approach

Author: Jin Cao Lorán Chollete

PII: S1572-3089(16)30218-2
DOI: http://dx.doi.org/doi:10.1016/j.jfs.2016.12.002
Reference: JFS 509

To appear in: *Journal of Financial Stability*

Received date: 7-9-2015
Revised date: 7-12-2016
Accepted date: 8-12-2016

Please cite this article as: Jin Cao, Lorán Chollete, Monetary policy and financial stability in the long run: A simple game-theoretic approach, *<![CDATA[Journal of Financial Stability]]>* (2016), http://dx.doi.org/10.1016/j.jfs.2016.12.002

This is a PDF file of an unedited manuscript that has been accepted for publication. As a service to our customers we are providing this early version of the manuscript. The manuscript will undergo copyediting, typesetting, and review of the resulting proof before it is published in its final form. Please note that during the production process errors may be discovered which could affect the content, and all legal disclaimers that apply to the journal pertain.

*Manuscript, excluding Author Details ACCEPTED MANUSCRIPT
Click here to download Manuscript, excluding Author Details: CC_JFS.pdf Click here to view linked References

Monetary policy and financial stability in the long run: A simple game-theoretic approach☆

Jin Cao[a,b,*], Lorán Chollete[c]

[a]Research Department, Norges Bank, Bankplassen 2 PB1179 Sentrum, NO-0107 Oslo, Norway
[b]CESifo, Germany
[c]School of Economics and Finance, University of St. Andrews, Castlecliffe, The Scores St Andrews, FIFE, KY16 9AR, UK

Abstract

Many theoretical central bank models use short horizons and focus on a single tradeoff. However, in reality, central banks play complex, long-horizon games and face more than one tradeoff. We account for these strategic interactions in a simple infinite-horizon game with a novel tradeoff: tighter monetary policy deters financial imbalances, but looser monetary policy reduces the likelihood of insolvency. We term these factors discipline and stability effects, respectively. The central bank's welfare decreases with dependence between real and financial shocks, so it may reduce costs with correlation-indexed securities. An independent central bank cannot in general attain both low inflation and financial stability.

JEL Codes: E50, G21, G28

Keywords: Central banking, Correlation-indexed security, Discipline effect, Stability effect, Strategic interaction

1. Introduction

The aftermath of the 2008 crisis featured a large effort by central banks and monetary authorities to address the question of financial fragility. In particular, central banks attempted to utilize novel methods to shore up the financial system and stave off potential incipient crises. A natural challenge concerns the extent to which central banks can actually achieve the goal of monitoring financial stability, while conducting more traditional roles of managing price and output stability. Our paper attempts to address this issue.

☆We thank Iftekhar Hasan (Editor), two anonymous referees, as well as seminar participants at DIW Berlin, Newcastle University, University of Munich, 2014 CESifo Area Conference on Macro, Money & International Finance, the Surrey-Fordham Conference on "Banking, Finance, Money and Institutions: The Post Crisis Era", and 2014 European Economic Association Meetings for useful comments and discussions. Chollete acknowledges support from Finansmarkedsfondet, of the Research Council of Norway. This paper should not be reported as representing the views of Norges Bank. The views expressed are those of the authors and do not necessarily reflect those of Norges Bank.

*Corresponding author
Email addresses: jin.cao@norges-bank.no (Jin Cao), lc245@st-andrews.ac.uk (Lorán Chollete)

Preprint submitted to Elsevier *December 7, 2016*

Accepted Manuscript

Download English Version:

https://daneshyari.com/en/article/5106545

Download Persian Version:

https://daneshyari.com/article/5106545

Daneshyari.com