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Non-standard monetary policy, asset prices and macroprudential policy in a monetary union

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Abstract

This paper evaluates the interaction of non-standard monetary measures and macroprudential policy in a monetary union by developing a two-region model of the euro area (EA) and simulating the Eurosystem's Asset Purchase Programme (APP). In each region some households are subject to a borrowing constraint, and the local real estate is used as collateral. Our results are as follows. First, in one region a large loan-to-value (LTV) ratio can amplify the positive effect of the union-wide APP on domestic households' borrowing. Second, during the APP implementation, overly optimistic (i.e., non-fundamental) expectations about local real estate prices would further augment households' borrowing in that region. Third, region-specific macroprudential measures that stabilize private debt can counteract the effects of the optimistic expectations and favor a macroeconomic expansion driven only by fundamentals, i.e., the APP, without the need to scale back the latter. Fourth, both the APP and the region-specific macroprudential policy bring about a welfare improvement.

JEL Classification Numbers: E43; E44; E52; E58.

Keywords: monetary union, open-economy macroeconomics, non-standard monetary policy, zero lower bound, macroprudential policy.

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