

# Author's Accepted Manuscript

## Scarcity of Safe Assets, Inflation, and the Policy Trap

David Andolfatto, Stephen Williamson



PII: S0304-3932(15)00049-5  
DOI: <http://dx.doi.org/10.1016/j.jmoneco.2015.03.008>  
Reference: MONEC2776

To appear in: *Journal of Monetary Economics*

Received date: 23 January 2015  
Revised date: 13 March 2015  
Accepted date: 16 March 2015

Cite this article as: David Andolfatto, Stephen Williamson, Scarcity of Safe Assets, Inflation, and the Policy Trap, *Journal of Monetary Economics*, <http://dx.doi.org/10.1016/j.jmoneco.2015.03.008>

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 galley proof before it is published in its final citable 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.

# Scarcity of Safe Assets, Inflation, and the Policy Trap\*

David Andolfatto

Federal Reserve Bank of St. Louis and Simon Fraser University

Stephen Williamson

Federal Reserve Bank of St. Louis and Washington University in St. Louis

April 17, 2015

## Abstract

A goal of this paper is to make sense of the seemingly puzzling behavior of interest rates and inflation - and the role of central banks in that behavior - during and after the Great Recession, particularly in the United States. To this end, we construct a model in which government debt plays a key role in exchange, and can bear a liquidity premium. If asset market constraints bind, then there need not be deflation under an indefinite zero interest rate policy (ZIRP). Further, ZIRP may not be optimal under these circumstances. A Taylor-rule central banker could be subject to a ZIRP trap and persistently undershoot target inflation. As well, a liquidity premium on government debt creates additional Taylor rule perils, because of a persistently low real interest rate. We make a case that this is the key policy predicament currently faced by many central banks in the world.

## 1 Introduction

In this paper, we start with a basic idea – that modeling the role of all government and central bank liabilities as liquidity can give us important insights into the behavior of inflation, interest rates, and the effects of monetary policy. We then show how this can matter for our understanding of the Great Recession and its aftermath, and for the performance of conventional monetary policy rules.

---

\*Prepared for the November 2014 Carnegie/Rochester/NYU Conference on Public Policy. This paper represents the views of the authors, and not those of the Federal Reserve Bank of St. Louis, the Federal Reserve System, or the Board of Governors. We wish to thank seminar participants at the Federal Reserve Bank of St. Louis, participants at the Carnegie/Rochester/NYU conference at Carnegie-Mellon University, November 2014, Huberto Ennis, and Marvin Goodfriend, for their helpful comments and suggestions.

Download English Version:

<https://daneshyari.com/en/article/7368818>

Download Persian Version:

<https://daneshyari.com/article/7368818>

[Daneshyari.com](https://daneshyari.com)