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Keep in mind

Autor o Editor
Álvaro José Riascos

This paper studies the performance, in terms of volatility and welfare, of different monetary policy rules in an economy with two market frictions. We consider a financial friction that highlights the credit channel as the monetary transmission mechanism and a labor friction, that considerably amplifies the effects of monetary policy. We first document some empirical facts including, the strong relation between prices and inflation with the main measures of labor supply (i.e. a short run Phillips Curve) and the short run expansionary effects of monetary policy. We then build a model roughly consistent with these facts. We use our model to study output and inflation volatility under different monetary policy rules, when the economy is subject to productivity and/or government spending shocks. We consider some of the rules widely discussed in the literature (i.e. Taylor Rules). In terms of output and inflation volatility, our results call for pure inflation targeting and/or interest rate smoothing when the economy is subject to productivity shocks. In terms of welfare, differences are negligible under the different policy rules considered.