INSTITUT FÜR HÖHERE STUDIEN
INSTITUTE FOR ADVANCED STUDIES
Vienna

Joint
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- March 04, 2010, 2 pm
- HS II (lecture room II)
  Institute for Advanced Studies
  Stumpergasse 56, A – 1060 Wien
  http://economics.ihs.ac.at/seminars

JOINT VIENNA MACROECONOMICS SEMINAR

Ester FAIA,
Goethe University Frankfurt, Kiel IfW and CEPREMAP:

"A Tale of Two Policies: Prudential Regulation and Monetary Policy with Fragile Banks"

Abstract

We introduce banks, modeled as in Diamond and Rajan (JoF 2000 or JPE 2001), into a standard DSGE model and use this framework to study the role of banks in the transmission of shocks, the effects of monetary policy when banks are exposed to runs, and the interplay between monetary policy and Basel-like capital ratios. In equilibrium, bank leverage depends positively on the uncertainty of projects and on the bank's "relationship lender" skills, and negatively on short term interest rates. A monetary restriction reduces leverage, while a productivity or asset price boom increases it. Procyclical capital ratios are destabilising; monetary policy can only partly offset this effect. The best policy combination includes mildly anticyclical capital ratios and a response of monetary policy to asset prices or leverage.

with Ignazio Angeloni (European Central Bank and BRUEGEL).