

Financial Frictions in Monetary DSGE Models

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Outline

- Take the baseline New Keynesian model as given.
- Most influential model of financial frictions in DSGE models at this point: *Costly State Verification* model
 - Careful discussion of microeconomics and GE of model.
 - Quantitative impact of integrating CSV into New Keynesian DSGE model.
- Two other models of financial frictions, based on moral hazard.
 - Impact on aspects of ‘unconventional monetary policy’.
- A different type of financial market friction: zero lower bound on nominal rate of interest.
 - Dangers for the economy.
 - Policy responses (will look at government spending and other responses).
- Possibly: monetary policy and stock market booms.
- General themes:
 - Potential failures of financial markets.
 - How policy reacts depends on the details of the market failure.