The asymmetric effects of monetary policy in a matching model with a balance sheet channel

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Abstract

This paper shows that monetary policy can have asymmetric effects in a matching model along the lines of D. Mortensen and C. Pissarides [1994. Job creation and job destruction in the theory of unemployment. Review of Economic Studies 61, 397–415]. When a balance sheet channel is at work. When a lender matches an entrepreneur, the investment project is financed and carried out. There is incomplete information ex post: firms can be randomly hit by shocks that change their financial position. If this falls under a critical value there is investment destruction. The asymmetric behavior of financial prices and investment flows following a monetary shock provides an explanation for monetary contractions having a greater effect than equally sized monetary expansions.

JEL classification: E32; E44; E52

Keywords: Asymmetric monetary policy; Balance sheet channel; Matching model

1. Introduction

A recent stream of literature has focused on the asymmetric effects on output of tight and easy monetary policies: the reduction in output following a negative monetary policy shock is assumed to be bigger than the expansion induced by a positive one.

The theoretical reasons for an asymmetric effect of monetary policy fall into one of the following categories: asymmetric price adjustment, the term structure of interest rates, credit market imperfections. In this paper, we focus on the third possibility.

The asymmetric effects of monetary policy will be explored in a model where the choice of funding and implementing a new investment project or destroying an existing one is a function of the balance sheet position of the entrepreneur. In such a model the meeting of the entrepreneur-borrower and the lender is modelled by means of a matching function which incorporates the difficult relationship between lender and borrower.

The so called matching models have been applied mostly to the labor market. In recent years, however, on the ground of the similarities between labor and credit market relationships, the matching framework has been extended to describe the credit market when either a monetary or a lending channel is present. What seems to be absent in this stream

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2 Ball and Mankiw (1994).
3 Garibaldi (1997) uses a matching model to describe the asymmetric response of job creation and job destruction to changes in interest rates.
4 Wasmer and Weil (1999) analyze both labor and credit market imperfections by means of a matching model with an exogenous job destruction rate. Dell’Ariccia and Garibaldi (1998, 2000), instead, use a stochastic matching model with an endogenous job destruction rate to show the asymmetric response of bank lending to movements in money market interest rates.
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