



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.

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1. Introduction

A recent stream of literature¹ 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.

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¹ Cover (1992), De Long and Summers (1988), Morgan (1993), and Karras (1996).

Nomenclature

c	cost of recruiting a lender
m	matching function
q	probability for an investment to find funds
r	market interest rate
u	rate of unemployed loans
v	rate of unfunded investment
x	net worth, cash flow
β	bargaining power
η	common shock
θ	credit market tightness
λ	arrival rate of Poisson process
ρ	loan interest rate
ϕ	external finance premium
F	common distribution of x
I	investment project
J	financed investment
\bar{N}	amount of funds in the market
R	reservation level of net worth
U	value of income to a potential lender
V	unfunded investment
W	value of the match to the lender

The theoretical reasons for an asymmetric effect of monetary policy fall into one of the following categories: asymmetric price adjustment,² 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.³ 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.⁴ What seems to be absent in this stream

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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