

A Model of Intermediation, Money, Interest, and Prices*

FIRST DRAFT: November 2016 | CURRENT DRAFT: July 2019

Saki Bigio[†] and Yuliy Sannikov[‡]

August 11, 2019

Abstract

A model integrates a modern implementation of monetary policy (MP) into an incomplete-markets monetary economy. Policy sets corridor rates and conducts open-market operations and fiscal transfers. These tools grant independent control over credit spreads and inflation. We study the implementation of spreads and inflation via different MP instruments. Through its influence on spreads, MP affects the evolution of real credit, interests, output, and wealth distribution (both in the long and the short run). We decompose effects through different transmission channels. We study the optimal spread management and find that the active management of spreads is a desirable target.

Keywords: Monetary Economics, Monetary Policy, Credit Channel.

JEL: E31-2, E41-4, E52-2

*We would like to thank Alex Carrasco and Mengbo Zhang for outstanding research assistance. We also thank Andrew Atkeson, Pierpaolo Benigno, Anmol Bhandari, Javier Bianchi, Markus Brunnermeier, Vasco Curdia, Chris Edmond, Emmanuel Farhi, Aubhik Kahn, Greg Kaplan, Galo Nuño, Guillermo Ordonez, Juan Passadore, Guillaume Rocheteau, Martin Schneider, Thomas Sargent, Gianluca Violante, Dimitri Vayanos, Amilcar Velez, Pierre-Olivier Weill, Diego Zuñiga, and seminar participants at the California Macroeconomics Conference at Clairmont McKenna College, European University Institute, Einaudi Institute for Economics and Finance, Stanford, UC Davis, UC Irvine, UCLA, Ohio State, UC Riverside, UC Santa Cruz, University of Queensland, Royal Bank of Australia, London School of Economics. Anthony Brassil and Walker Ray provided us with excellent critical discussions. Bigio thanks the National Science Foundation (NSF award number: 1851752) for its support.

[†]Department of Economics, University of California, Los Angeles and NBER, email: sbigio@econ.ucla.edu.

[‡]Stanford Business School and NBER, email: sannikov@gmail.com.