

Macroeconomic Policy in a Real Business Cycle Model with Money

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Abstract

This paper examines the impact of macroeconomic policy shocks in a Real-Business-Cycle Model with money. In addition to technology shocks, I include government consumption, government investment, tax rate and monetary policy as sources of random disturbances. Money is introduced in a shopping-time economy. In search of liquidity effect and persistent output effect in response to monetary shocks, a simple Taylor's rule is employed as an alternative approach of modeling monetary policy. The results show that (1) the extended model does a good job of mimicking the characteristics of post-war business cycles, however, it fails to capture some dynamic responses to monetary policy shock; (2) it is obvious, however, that monetary and fiscal shocks play important roles in the explanation of post-war business cycles; (3) incorporating Taylor's rule in the extended model improves the performances in the dynamic responses of nominal shocks. It not only captures liquidity effect but also generates higher persistence in output.

Keywords: Business cycles, Fiscal policy, Monetary policy, Taylor rule.

JEL Classification: E62, E52, E32, E31

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