

CENTRAL BANK RESERVES REQUIREMENT, MONETARY SHOCKS, AND LABOUR MARKET FLUCTUATIONS ^(a)

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ABSTRACT

This paper presents a monetary stochastic general equilibrium model with bank reserves and no money illusion that allows the real cyclical movements of the economy to be explained as a consequence of exogenous monetary shocks. The ultimate intention is to show that monetary shocks are relevant in explaining the economy's real fluctuations in an RBC model, and therefore constitute an alternative to technology shocks in capturing the dynamic features of the real fluctuations. There are two main features of the model. The first is the consideration of a financial intermediary that must meet legal reserve requirements, something implying real effects for exogenous monetary policy shocks. The second is the non existence of money illusion, a feature that makes it possible to formulate the monetary equilibrium as a real equilibrium easy to solve, calibrate and simulate. The proposed model is calibrated and simulated, and its accuracy in replicating the properties of the cyclical movements in the real variables is evaluated and compared with that of the standard RBC models in the literature.

JEL classification: D5, E4, E5.

Keywords: Stochastic General Equilibrium Model; Reserve Requirements; Money Illusion; Real Business Cycle Models; Labour Market Puzzles; Simulation.

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