 Download This Paper (Delivery.cfm/SSRN\_ID2182229\_code1851421.pdf?abstractid=2182229&mirid=1)

Open PDF in Browser (Delivery.cfm/SSRN\_ID2182229\_code1851421.pdf?abstractid=2182229&mirid=1&type=2)

★ Add Paper to My Library

Share:    

## Financial Stability, Deflation, and Monetary Policy

*FRB Richmond Working Paper No. 01-1*

33 Pages  
Posted: 29 Nov 2012

Marvin Goodfriend (https://papers.ssrn.com/sol3/cf\_dev/AbsByAuth.cfm?per\_id=16378)  
Carnegie Mellon University - David A. Tepper School of Business; National Bureau of Economic Research (NBER)

Date Written: January 1, 2001

### Abstract

The paper explores the relationship between financial stability, deflation, and monetary policy. A discussion of narrow liquidity, broad liquidity, market liquidity, and financial distress provides the foundation for the analysis. There are two preliminary conclusions. Equity prices are a misleading guide for interest rate policy. Monetary policy tactics protect market liquidity while maximizing the central bank's leverage over longer-term interest rates and aggregate demand.


Monetary policy is a fundamental source of deflation and stagnation risk when price stability is fully credible. A central bank can be fooled by its own credibility for low inflation into being insufficiently preemptive in a business expansion. Then monetary policy can be constrained by the zero bound from reducing real interest rates enough in the subsequent contraction. The chain of events that leads to deflation and stagnation can be weakened or broken in a number of places. Monetary policy has the power to preempt deflation and the power to overcome the zero bound to restore prosperity after a deflationary shock. Fiscal policy is likely to be relatively ineffective at best and counterproductive at worst.

**Keywords:** banking policy, deflation, financial distress, financial stability, liquidity, monetary policy, zero bound on interest rates

**JEL Classification:** E3, E5, E6, G3

[Suggested Citation](#) >

[Show Contact Information](#) >

 Download This Paper (Delivery.cfm/SSRN\_ID2182229\_code1851421.pdf?abstractid=2182229&mirid=1)

Open PDF in Browser (Delivery.cfm/SSRN\_ID2182229\_code1851421.pdf?abstractid=2182229&mirid=1&type=2)

## 74 References

1. S Aiyagari , Rao  
Uninsured Idiosyncratic Risk and Aggregate Saving  
Quarterly Journal of Economics , volume 109 , p. 659 - 84 Posted: 1994-08  
Crossref (https://doi.org/10.2307/2118417)

2. Ellen R \_\_\_\_\_ , Mcgrattan  
The Optimum Quantity of Debt  
Journal of Monetary Economics , volume 42 , p. 447 - 70 Posted: 1998-12

3. George A Akerlof , Paul M Romer  
Looting: The Economic Underworld of Bankruptcy for Profit  
Brookings Papers on Economic Activity , volume 2 , p. 1 - 73 Posted: 1993

We use cookies that are necessary to make our site work. We may also use additional cookies to analyze, improve, and personalize our content and your digital experience. For more information, see our [Cookie Policy](#)  
William E Alexander, M Jeffrey Williamson, Carl-Johan Ebrill, Lindgren  
Systemic Bank Restructuring and Macroeconomic Policy Posted: 1997

## 0 Citations

[Fetch Citations](#)

Do you have a job opening that you would like to promote on SSRN?

Place Job Opening (<https://www.ssrn.com/index.cfm/en/Announcements-Jobs/>)

## Paper statistics

DOWNLOADS	293
ABSTRACT VIEWS	1,571
RANK	192,070

14 Citations

74 References

PlumX Metrics



([https://plu.mx/ssrn/a/?ssrn\\_id=2182229](https://plu.mx/ssrn/a/?ssrn_id=2182229))

## Related eJournals

Macroeconomics: Monetary & Fiscal Policies eJournal ([https://papers.ssrn.com/sol3/JELJOUR\\_Results.cfm?form\\_name=journalBrowse&journal\\_id=1154269](https://papers.ssrn.com/sol3/JELJOUR_Results.cfm?form_name=journalBrowse&journal_id=1154269))

Follow



Macroeconomics: Prices, Business Fluctuations, & Cycles eJournal ([https://papers.ssrn.com/sol3/JELJOUR\\_Results.cfm?form\\_name=journalBrowse&journal\\_id=1154364](https://papers.ssrn.com/sol3/JELJOUR_Results.cfm?form_name=journalBrowse&journal_id=1154364))

Follow



[View more >](#)

## Recommended Papers

Monetary Policy and Asset Price Volatility ([https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=217836&rec=1&srcabs=2182229&pos=1](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=217836&rec=1&srcabs=2182229&pos=1))

By Ben S. Bernanke ([https://papers.ssrn.com/sol3/cf\\_dev/AbsByAuth.cfm?per\\_id=17851](https://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=17851)) and Mark Gertler ([https://papers.ssrn.com/sol3/cf\\_dev/AbsByAuth.cfm?per\\_id=62909](https://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=62909))

Asset Prices, Financial and Monetary Stability: Exploring the Nexus ([https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=846305&rec=1&srcabs=2182229&pos=2](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=846305&rec=1&srcabs=2182229&pos=2))

By Claudio E. V. Borio ([https://papers.ssrn.com/sol3/cf\\_dev/AbsByAuth.cfm?per\\_id=66911](https://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=66911)) and Philip William Lowe ([https://papers.ssrn.com/sol3/cf\\_dev/AbsByAuth.cfm?per\\_id=340545](https://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=340545))

Assessing the Risk of Banking Crises – Revisited ([https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1513316&rec=1&srcabs=2182229&pos=3](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1513316&rec=1&srcabs=2182229&pos=3))

By Claudio E. V. Borio ([https://papers.ssrn.com/sol3/cf\\_dev/AbsByAuth.cfm?per\\_id=66911](https://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=66911)) and Mathias Drehmann ([https://papers.ssrn.com/sol3/cf\\_dev/AbsByAuth.cfm?per\\_id=327246](https://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=327246))

[View more >](#)

Feedback

SSRN Quick Links	▼
SSRN Rankings	▼
About SSRN	▼

**f** (<https://www.facebook.com/SSRNcommunity/>)

**in** ([https://www.linkedin.com/company/493409?](https://www.linkedin.com/company/493409?trk=tyah&trkInfo=clickedVertical%3Acompany%2CentityType%3AentityHistoryName%2CclickedEntityId%3Acompany_493409%2Cidx%3)

[trk=tyah&trkInfo=clickedVertical%3Acompany%2CentityType%3AentityHistoryName%2CclickedEntityId%3Acompany\\_493409%2Cidx%3](https://www.linkedin.com/company/493409?trk=tyah&trkInfo=clickedVertical%3Acompany%2CentityType%3AentityHistoryName%2CclickedEntityId%3Acompany_493409%2Cidx%3)

**🐦** (<https://twitter.com/SSRN>)

(<http://www.elsevier.com/>)

Copyright (<https://www.ssrn.com/index.cfm/en/dmca-notice-policy/>)      Terms and Conditions (<https://www.ssrn.com/index.cfm/en/terms-of-use/>)

Privacy Policy (<https://www.elsevier.com/legal/privacy-policy>)

All content on this site: Copyright © 2023 Elsevier Inc., its licensors, and contributors. All rights are reserved, including those for text and data mining, AI training, and similar technologies. For all open access content, the Creative Commons licensing terms apply.

We use cookies to help provide and enhance our service and tailor content.

To learn more, visit [Cookie Settings](#).



(<http://www.relx.com/>)

(<https://papers.ssrn.com/sol3/updateInformationLog.cfm?process=true>)