Does Credit Matter? : A Dynamic General Equilibrium Analysis

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Abstract

The Japanese economy had been stagnating in the 1990s. The Bank of Japan continued to adopt monetary easing measures, but could not stimulate the economy. In the credit view, investment may be sensitive to net worth or cash flow if agency costs associated with asymmetric information exist and the cost of external finance is higher than that of internal finance. If this credit channels are important for the monetary transmission process, the level of interest rates may not be a relevant indicator of monetary policy.

This paper intends to evaluate the importance of credit channels. We develop dynamic general equilibrium models with and without agency costs and compare the results generated by the model simulation with empirical findings in the Japanese economy. If the model with agency costs can replicate the real economy, we can conclude that credit channels were important in Japan.

Key words: Monetary policy, Agency costs, Dynamic general equilibrium model

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