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Financial frictions and nominal wage rigidities in an estimated DSGE model

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Abstract

The role of bank's net worth shock in the variation of equity capital and the related consequences in business cycles are not well known in the context of Gertler and Karadi (2011)'s financial friction. This paper analyses so along with the capital quality shock which is mainly a valuation shock. The paper also provides an explanation of the mechanism of investment specific technology shocks within such financial friction after including labor market heterogeneity and nominal wage rigidities. A Bayesian estimation shows that financial shocks (net worth) and supply side shocks (technology and wage mark-up) are the two major players in the US output and employment variations. Second, the financial friction replaces the marginal efficiency of investment shock as a key driver of business cycles.

Keywords: Financial frictions, nominal wage stickiness, financial shock, DSGE

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