Liquidity, Financial Intermediation, and Monetary Policy in a New Monetarist Model

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Abstract

A model of monetary exchange with private financial intermediation is constructed. Claims on financial intermediaries of two types are traded in transactions: circulating notes and deposits. There can be a role for the government in supplying liquidity, and level changes in the money supply accomplished through open market operations can be nonneutral. A Friedman rule is suboptimal, due to costs of maintaining the stock of currency. The model is used to address some issues related to current monetary policy in the United States.