

Habit Formation, Interest-Rate Control and Equilibrium Determinacy ^{*}

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Abstract

We analyze macroeconomic stability in an economy with habit formation and the monetary policy rule of interest-rate control type. We assume that real money holdings bind gross consumption, and that the utility of leisure is not necessarily separable from the habit-adjusted consumption. Under the assumption of internal habit formation, there exists indeterminate equilibrium which is determinate in the economy without habit if monetary policy is active. Such equilibrium does not emerge when monetary policy is passive.

Keywords and Phrases: equilibrium determinacy, Taylor rule, habit formation, endogenous labor.

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