The Market Price of Risk and Monetary Policy

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Abstract

By integrating the Black-Sholes model and the Ramsey-type optimal growth model, we construct an equilibrium model in which the market price of risk (MPR) is independent of the relative risk aversion and prove that the changes in MPR affect equilibrium consumption-capital paths. If the monetary policy is to control the interest rates that accrue on the deposits, it changes the MPR and ends up altering the consumption-capital paths accompanying the changes in the endogenously determined quantity of money.

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