

The Liquidity Effect in the Monti-Klein Model

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Abstract

In this paper, we study the effect of monetary policy in an industrial-organization model of banking industry: the Monti-Klein model. Our main contributions are as follows. First, the Monti-Klein model raises *liquidity puzzle*, in which a tight monetary policy increases the money stock. Second, under a certain condition, introducing money creation into the model partly mitigates the puzzle. However, under the plausible setting of the parameters, the liquidity puzzle remains. Third, the unconventional monetary policy has the similar effect.

JEL classification: E51, E52, G21.