Abstract

This paper examines optimal policy rules in an economy where government debt and capital provide liquidity services and carry liquidity premia. When government debt and capital exhibit high liquidity premia, the heightened demand for liquid assets can lead to capital hoarding, which crowds out consumption. Addressing this issue through fiscal policy is challenging, as it may introduce distortions via higher tax burdens and increased tax rates. Because price is sticky, monetary policy can influence the collateral premium by altering the market value of government debt. Specifically, a monetary policy that raises interest rates in response to an increase in the premium can reduce expected future premia, effectively discouraging excessive capital accumulation and enhancing consumption.