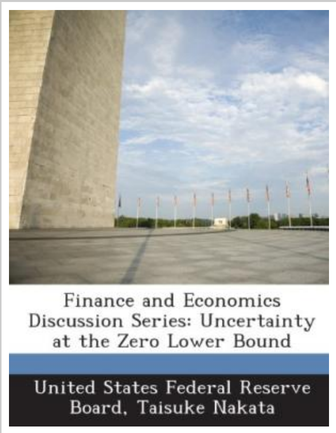

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Finance and Economics Discussion Series: Uncertainty at the Zero Lower Bound

By Taisuke Nakata

Bibliogov, United States, 2013. Paperback. Book Condition: New. 246 x 189 mm. Language: English . Brand New Book ***** Print on Demand *****.This paper examines how the presence of uncertainty alters allocations and prices when the nominal interest rate is constrained by the zero lower bound. I conduct the analysis using a standard New Keynesian model in which the nominal interest rate is determined according to a truncated Taylor rule. I find that an increase in the variance of shocks to the discount factor process reduces consumption, inflation, and output by a substantially larger amount when the zero lower bound is binding than when it is not. Due to the zero lower bound constraint, policy functions for the real interest rates and the marginal costs of production are highly convex and concave, respectively. As a result, a mean-preserving spread in the shock distribution increases the expectation of future real interest rates and decreases the expectation of future real marginal costs, which lead forward-looking households and firms to reduce consumption and set lower prices today. The more flexible prices are, the larger the effects of uncertainty are at the zero lower bound.

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