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Abstract

We introduce imperfect monetary policy transparency and strategic wage setting into a macro model where the central bank provides lender of last resort (LOLR) services to banks on top of its standard stabilisation policy. We study how, in the presence of adverse exogenous financial developments, macroeconomic and financial instability can be damped by adjustments in policy institutions and economic structure. In a context of costly LOLR transactions and no moral hazard, the central bank has an incentive to save only large banks. Central bank opaqueness can help improve macroeconomic and financial stability by making wages closer to their competitive levels. Some results depend on initial conditions concerning monetary institutions; for instance, monetary strictness and wage bargaining centralisation help discipline wages and thus are stability-enhancing when central bank policies are initially seen as rather strict and transparent. Some consideration is given to the roles of trade openness and moral hazard behaviour on the part of banks.