Macroeconomic Policy and the Price of Risk*

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Abstract

We explore the effects of monetary, fiscal, and macroprudential policies on risk premia and investment in a heterogeneous agent New Keynesian environment. Heterogeneity in agents' marginal propensity to save in capital (MPSK) summarizes differences in risk aversion, portfolio constraints, and background risk. Policies which redistribute to agents with high MPSKs reduce risk premia and, absent a monetary policy tightening, raise investment. We quantitatively evaluate the role of this mechanism for the transmission of conventional monetary policy. An unexpected reduction in the nominal interest rate redistributes to agents with high MPSKs. We characterize the necessary heterogeneity in MPSKs to rationalize the observed stock market and investment responses to monetary policy shocks.

JEL codes: E44, E63, G12

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