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Labor market imperfections, real wage rigidities and financial shocks

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ABSTRACT

By using the recent Gertler and Kiyotaki's (2010) setup, this paper explores the interaction between real distortions stemming from the labor market institutions and financial shocks. We find that neither labor market imperfections nor fiscal institutions determining tax wedges have an impact on the volatility of the real economy induced by a financial shock. By contrast, real wage rigidities matter as they amplify the financial shock effects. Thus, economies with larger imperfections will not systematically observe larger or smaller recessions, unless a causality between imperfections and real wage rigidities is introduced.

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