

# FINANCIAL STABILITY AND THE DESIGN OF MONETARY POLICY<sup>1</sup>

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## Abstract

This paper builds upon the existing empirical literature on the factors behind financial stability, focusing on the role of monetary policy design. In particular, it analyzes a sample of 79 countries in the period 1970 to 1999 to evaluate the effect of the choice of the central bank objectives and the monetary policy strategy on financial stability. We find that focusing the central bank objectives on price stability reduces the likelihood of a banking crisis. This result is robust, in general, to several model specifications and groups of countries. The results are less clear-cut for the monetary policy strategy although for some model specifications, in particular for the group of countries in transition, the choice of an exchange rate-based strategy appears to reduce the likelihood of a banking crisis. Finally, locating regulatory and supervisory responsibilities at the central bank seems to reduce the likelihood of a banking crisis when controlling for this variable.

JEL Classification: E52, E44, G21

Key words: Monetary policy design, monetary policy objectives, monetary policy strategy, financial stability, and banking crisis

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