

# Research Seminar "Quantitative Economics"

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## Abstract

### **Flight to Safety and New Keynesian Demand Recessions**

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#### Abstract

We incorporate flight to safety in a tractable New Keynesian model with incomplete markets and nominal safe assets. A rise in uncertainty induces a flight to safety, where investors shift portfolios from risky productive capital to nominal government bonds. Under price stickiness, the real value of nominal safe assets cannot adjust flexibly, causing capital price overshooting and aggregate demand recessions. Conventional monetary policy through the nominal rate has limited power in mitigating these recessions, as it fails to directly affect portfolio reallocation between safe and risky assets. Instead, optimal monetary policy allows temporary deviations from price stability, leveraging inflation dynamics to indirectly manage safe asset supply.