

# Referee report on: Stock prices and monetary policy. Re-examining the issue in a New Keynesian model with endogenous investment

## **General comments**

The paper extends the New Keynesian model by the endogenous investment with bubble behaviour to examine two main issues: Should central banks include some financial indicator in their policy rules and which indicator should be used. The model design is convincing, but relies on the work of Bernanke and Gertler. Therefore, the description should be shortened in Chapter 2. It should only clarify the difference to the base model of Bernanke and Gertler.

The discussion of policy rules covers a lot of relevant cases. Nevertheless, Sveen and Weinke (2010) include current looking interest rate rules and Duffy and Xiao (2011) backward looking interest rates. Their models are used to solve determinacy problems. Maybe the authors could comment on this topic and extend their cases of policy rules.

## **Minor comments**

**Page 2, lower part of the last paragraph:** Inflation targeting is not only practised on a short-term basis. The Bank of England wants to stabilize the medium term inflation forecast.

**Page 3, line 1:** The central of Sweden explained its last central bank increase due to the house price development. Hence, an asset price seems to be in its object function.

**Page 3, last sentence of the second paragraph:** Moreover, the buildup of a bubble is connected by credit development. Increase of central bank interest rates may raise the credit interest rates and therefore the credit costs.

**Page 5, line 17:** Please change 'fiancial' into 'financial'.

**Page 5, line 22:** Please change 'costs' into 'costs.'.

**Page 17, Table 1:** The probability of collapse of bubbles is very high. Maybe you could try lower values like 0.2 or 0.25.

**Page 19, line 8:** Please give a hint that the results reflect the long run results of the model because 120 periods is very long. It indicates the stability of the model.

**Page 20, last paragraph:** The authors write a lot about inflation aggressive and output aggressive. However the results are not shown. At least, they should be offered to readers upon request.

**Page 21, line 13:** The knowledge of central banks is not so high. Their ability and willingness to detect bubbles are weak.

**Page 25, line 7:** Please change 'the the' into 'the'.

**Pages 25-27, References:** There are some typos in the reference list. Moreover, the authors cite a lot of discussion papers. Some of them are published in the meantime.

**Page 28, Figure 1:** Please use of digit more at your vertical axis.

**Page 30, Figure 3:** One legend is enough.

## References

Duffy, John, and Wei Xiao (2011) Investment and Monetary Policy: Learning and Determinacy of Equilibrium, *Journal of Money, Credit, and Banking*, vol. 43(5), pp. 959-992.

Sveen, Tommy, and Lutz Weinke (2010) The Taylor Principle in a medium-scale macroeconomic model, Working paper 2010/09 Norges Bank, Oslo.