Financial Accelerator Mechanism in a Small Open Economy

Working Paper No. 525 Keep in mind
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Using Bayesian estimation techniques, we estimate a small open economy DSGE model with credit-market imperfections for the Colombian economy. Using the estimated model we investigate what are the sources of business cycle fluctuations. We show that balance-sheet effects play an important role in explaining recent Colombian business cycles. We then perform a counterfactual exercise that shows that fixed exchange rate regime could have exacerbated the financial distress in the economy between 1998-1999.

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Fuente: https://www.banrep.gov.co/en/borrador-525