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The objective of this paper is to analyze how international cycles affect the real GDP cycle and so monetary policy decisions in Colombia. We estimate that cycles in world GDP, export prices and capital inflows are strongly associated with the Colombian business cycle both on impact and even during the first year. We find evidence that, because of inefficiencies in the domestic financial sector, external gains are channelled into nontradable spending through credit expansions. This creates large appreciations during booms. The reverse happens during world slowdowns. These swings in the Exchange rate restrict the scope for a countercyclical monetary policy.

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