Financial Accelerator Mechanism: Evidence for Colombia

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Colombia experienced a deep recession in 1999-2003. Growth slowed by 4.2%, and investment by 34.6%. Was the severity of the recession due to a financial accelerator mechanism á la Bernanke, Gertler, and Gilchrist (1999)? To answer this question, this paper estimates a dynamic stochastic general equilibrium model with credit-market imperfections for the Colombian economy using Bayesian methods. The results show that balance-sheet effects played an important role in explaining recent Colombian recession; the financial accelerator mechanism turns out to be quantitatively significant accounting for about 50 percent of the total reduction in output after a monetary policy tightening.

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