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House Prices and Monetary Policy in Colombia

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This paper investigates the possible responses of an inflation-targeting monetary policy in the face of asset price deviations from fundamental values.
Focusing on the housing sector of the Colombian economy, we consider a general equilibrium model with frictions in credit market and bubbles in housing prices. We show that monetary policy is less efficient when it responds directly to asset price of housing than a policy that reacts only to deviations of expected inflation (CPI) from target. Some prudential regulation may provide a better outcome in terms of output and inflation variability.

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