



Banking Productivity and Economic Fluctuations: Colombia 1998-2000

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I build a general equilibrium, financial accelerator model that incorporates an explicit technology for the intermediary sector. A credit multiplier emerges because of a borrowing constraint that is a function of asset prices, internal funds and lending rates. With this financial friction I show that small changes in the productivity and intermediation costs of banks generate large and persistent fluctuations in economic activity. The transmission channel relies on the role that assets and internal funds play as collateral. After a negative shock hits financial intermediation productivity, the resulting credit crunch and economic slowdown induce a fall in asset prices and internal fund accumulation. This further modifies the present and future volume of collateral, thereby amplifying and propagating the initial shock. I argue that changes in banking regulation in Colombia in the late 1990's increased intermediation costs, reduce banking productivity and induced a credit channel story that fits the theoretical model presented here. This new regulation enhanced the credit crunch and economic slowdown that was already underway. Colombian data on loan/deposit interest rates spreads, credit volume, asset prices and economic activity support this argument.

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