A Dynamic Stochastic General Equilibrium model to analyze the effect of monetary policy on the Bolivian financial system

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Abstract

The international financial crisis that began in 2007 has made it clear that macroeconomic models have to assign a greater role to the financial sector in order to understand the dynamics of the economic cycle. The objective of this paper is to understand the interactions between the banking sector and the rest of the economy, in particular, to understand the impact of monetary policy measures (changes in the legal reserve ratio and injections of liquidity) on the performance of the activity of financial intermediation. A DSGE model was used for this purpose. The results of the model show that monetary policy, either through liquidity injection or changes in the legal reserve rate, would have an effect on the performance of the financial system, and thus on financial stability. Increase in liquidity would have positive effects in terms of financial stability, while increases in the reserve ratio could be used to contract the excessive expansion of credit.

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