

Risk perception, dollarization and monetary policy in Bolivia

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ABSTRACT

This paper presents a theoretical model that allows defining concepts of currency substitution and dollarization. Considering this theoretical framework is analyzed the determinants of dollarization in Bolivia during recent years. The main findings show that although real returns and variability of interest rates have favored financial assets in domestic currency, and that the pace of depreciation and its variability have decreased, dollarization has remained in similar levels. It is possible that the high propensity of maintaining dollar-denominated assets be explained by expectations of economic agents who assign a positive probability, even small, to an important change in the fundamentals of the economy, in this case, a great depreciation of exchange rate. In the economic literature, this phenomenon is known as “peso problem”. In this context the more viable alternative to reverse the dollarization process seems to be the use of policies that guarantees and promotes the use of domestic currency.