

The renaissance of Friedman hypothesis: Nature of global financial crisis and consequences in a small open and highly dollarized economy

Pablo Mendieta Ossio

ABSTRACT

This paper analyzes the US subprime crisis from a business cycles perspective. For this purpose, it employs a macroeconomic model with endogenous financial imperfections, where central bank's only objectives are output and inflation, using a Small Structural Macroeconometric Model (SSMM). The results show that financial frictions could generate an economic cycle through monetary policy reactions, according to old fashioned Milton Friedman's business cycles origins hypothesis. The model is calibrated according to the American economy recent experience. It also studies the consequences of this crisis in a small open and highly dollarized country, like Bolivia. The paper concludes that in order to achieve global price stability, potential structural problems must be addressed in order to avoid non desired effects; and that policy makers must improve their ability to anticipate future evolution of the economy.

JEL Classification: C5, E3, F00

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