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Note by the invited editors

Tenth Special Edition on Monetary Policy and Financial Stability in Small and Open Economies

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Introduction

This special edition of *Ensayos Sobre Política Económica* (ESPE) is devoted to research papers dealing with the topic of monetary policy and financial stability in small and open economies. Colombia and other Latin-American countries lie within this classification.

The importance of this topic relies mainly on the economic events that occurred around the world in the last five years, in which financial stability problems and their subsequent active monetary-policy responses have been the center stage. The decisions made by the Federal Reserve, the Bank of England and de European Central Bank in order to confront the 2008-2009 crisis are well known and are useful as future guidance. Although it is not clear whether developing, small-open economies should respond with similar strategies, some of the actions taken are indeed applicable. In fact, many developing countries suffered severe financial crises (Russia, Colombia and South Asian) during the late 1990's and the implemented policies at that time can be regarded as an anticipation of those recently applied by developed economies.

Central Banks around the world have turned their attention to financial stability. This change of focus has brought new challenges and policy trade-offs that are still unresolved. The topics covered in this edition try to contribute to the debate on the way policy-makers deal with the new challenges on monetary and financial policy.

The call for papers for this special edition was first published on October 2012 with a set of questions related to the main research object. Some of the topics included were the following: financial cycles, credit market behavior, exuberance in asset prices, financial regulation, credit boom determinants, financial decisions by firms, public debt composition and systemic risk.

We received a large number of papers in June 2013 which went through a rigorous evaluation. The articles selected for publication were announced at the end of August 2013. These papers were written by researchers from Banco de la República as well as from other research institutions around the globe.

International Speakers

These selected papers were presented at the annual conference of the special edition of the journal, which took place on October 17th and 18th of 2013 in Bogotá D.C. Two distinguished international scholars were invited as keynote speakers of the conference. They presented lectures on frontier issues related to financial stability and monetary policy.

First, Professor Yi Wen, Assistant Vice President of the Federal Reserve Bank of at St. Louis (Missouri, United States), gave us a lecture on the evaluation of unconventional monetary policies. It is important to note that due to the recent financial problems faced by several countries, central banks have changed their monetary-policy strategies; this new strategies usually incorporate financial stability concerns and therefore should be evaluated differently. Professor Wen's conference illustrated various new methodologies for performing these evaluations.

We also welcomed Professor Francois Gourio from Boston University, who works also at the research department of the Federal Reserve Bank of Chicago. Professor Gourio talked about a new economic approach to modeling the macroeconomic interactions among economic activity, asset prices and credit risk. This approach is known as "Disaster risk" and it is based on the seminal ideas of Robert Barro (2006). This approach consists of modeling the long run macroeconomic risk perception through a time-varying probability of an event of economic disaster. Fluctuations of this subjective probability might potentially explain those economic fluctuations which are not explained by fluctuations in productivity.

Accepted Articles

This special edition of ESPE contains seven original research articles which can be classified into two big categories.

The first group focuses on monetary policy mechanisms and credit market behavior. Marcelo Sánchez describes a monetary policy model that studies the interaction between Central Bank transparency, its function as a lender of last resort and wage determination in the context of financial instability. Camilo González's article focuses on the behavior of the interbank market by suggesting mechanisms in which low-risk banks may end up having access to liquidity under better financial conditions. The article by Camilo González, Luisa Silva, Carmiña Vargas, and Andrés Velasco also studies the interbank market and presents a dynamic stochastic model which is useful for understanding the determination of both interest rates and quantities in equilibrium.

The second group of papers focuses on studying credit-market mechanisms using both macro and micro approaches. The article by Franz Hamman, Rafael Hernández, Luisa Silva, and Fernando Tenjo makes an analysis of Colombian banks, the dynamics of their balance sheets, credit supply, leverage and their relation with the business cycle. Alexander Guarin, Andrés González, Daphne Skandalis, and Daniela

Sánchez propose an econometric methodology for the detection of credit booms using macroeconomic aggregates which is applied to six Latin-American economies. The research by Esteban Gómez, Andrés Murcia, and Nancy Zamudio introduces a credit market model, under a principal-agent approach, which studies the effects of capital-flow shocks on firms' credit and financial decisions. Finally, Alexander Díaz presents an econometrics analysis of the causal relationship between credit (total and private) and aggregate production by using historical data from four Latin-American countries.

Due the wide scope of this call for papers, there are some topics to be addressed which are of interest to Banco de la República and its Board of Governors. For instance, the design of optimal monetary policy taking into account financial stability considerations, the cost-benefit analysis of macro-prudential policies, sovereign risk and financial stability, booms in asset prices, risks and regulations of financial conglomerates and finally, systemic risk. We extend an invitation to national and international researchers interested in these topics to submit their works for futures issues of ESPE.

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