

< Risk Matters: The Real Effects of Volatility Shocks

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Article Information

Abstract

We show how changes in the volatility of the real interest rate at which small open emerging economies borrow have an important effect on variables like output, consumption, investment, and hours. We start by documenting the strong evidence of time-varying volatility in the real interest rates faced by four emerging economies: Argentina, Brazil, Ecuador, and Venezuela. We estimate a stochastic volatility process for real interest rates. Then, we feed this process in a standard small open economy business cycle model. We find that an increase in real interest rate volatility triggers a fall in output, consumption, investment, hours, and debt. (JEL E13, E20, E32, E43, F32, F43, O11)

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Additional Materials

Replication Package (77.40 KB)

Online Appendix (234.50 KB)

JEL Classification

E13 General Aggregative Models: Neoclassical

E20 Macroeconomics: Consumption, Saving, Production, Employment, and

Investment: General (includes Measurement and Data)

E32 Business Fluctuations; Cycles

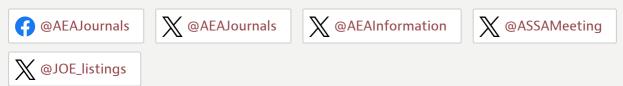
E43 Interest Rates: Determination, Term Structure, and Effects

F32 Current Account Adjustment; Short-term Capital Movements

F43 Economic Growth of Open Economies

011 Macroeconomic Analyses of Economic Development

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