

---

[Working Paper No. 852](#)

Keep in mind

The series Working Papers on Economics is published by the Office for Economic Studies at the *Banco de la República* (Central Bank of *Colombia*). The works published are provisional, and their authors are fully responsible for the opinions expressed in them, as well as for possible mistakes. The opinions expressed herein are those of the authors and do not necessarily reflect the views of Banco de la República or its Board of Directors.

AUTHOR OR EDITOR

Jesús A. Bejarano

Luisa F. Charry

AUTHORS AND/OR EDITORS

[Luisa F. Charry](#)

---

---

In this paper we set up a small open economy model with financial frictions, following Curdia and Woodford (2010)'s model. Unlike other results in the literature such as Curdia and Woodford (2010), McCulley and Ramin (2008) and Taylor (2008), we find that optimal monetary policy should not respond to changes in domestic interest rate spreads when the source of fluctuations are exogenous financial shocks. A novel result here is that the optimal size of policy responses to changes in the credit spread is large when the disturbance source are shocks to the foreign interest rate. Our results suggest that such a response is welfare enhancing.

The opinions expressed here do not necessarily correspond neither to the Banco de la República nor its Board of Directors.