

# Financial Regulation, Credit and Liquidity Policy and the Business Cycle

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## Abstract

Following the global financial crisis that started in 2007, US and Europe have experienced increased volatility in both nominal and real variables and massive swings in the stock markets. This has prompted global financial regulation committees and national monetary authorities to seek better ways of monitoring and regulating the financial and credit markets, so as to reduce economic volatility in times of financial shocks. In this paper we set up a DSGE model, with credit market frictions and an endogenous probability of default, where the risk of borrowers, (intermediate goods firms), is carried by commercial banks and their bank equity holders. We examine how financial regulation and macro-prudential monetary policy (including Basel, II and III, countercyclical bank capitals rules and liquidity rules) may affect the business cycle in times of demand, supply and financial shocks (collateral and credit shocks).

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