

# FINANCIAL DEEPENING, EXTENT OF BUSINESS FLUCTUATIONS, AND POLICY EFFECTIVENESS

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## Abstract

In this paper, we develop a model of financial deepening, economic growth, and business fluctuations. We explore the effects of the changes in financial depth on resource allocation (credit allocation), an aggregate TFP level, and an economic growth rate. Moreover, we investigate the relationship between the degree of financial deepening and policy effectiveness such as the effectiveness of monetary policy as well as the extent of business fluctuations. We find that there are three stages of financial deepening. Which stages the financial system reaches is crucial in determining the economic growth rate, the extent of business fluctuations, and the effectiveness of monetary policy.

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