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This paper assesses the importance of financial market developments for the business cycle in Brazil. The results underscore the importance of macro-financial linkages and highlight risks to the recovery going forward. Although some of the rise in credit growth in Brazil can be attributed to financial deepening and rising income levels, it may have implications for economic activity going forward. Cross-country evidence suggests that periods of easy financial conditions can amplify economic fluctuations and possibly lead to adverse economic outcomes. To explore the nexus between the financial cycle and business cycle, cycles are estimated using a variety of commonly-used statistical methods and with a small, semi-structural model of the Brazilian economy. An advantage of using the model-based approach is that financial and business cycles can be jointly estimated, allowing information from all key economic relationships to be used in a consistent way. Financial sector developments are found to be an important source of macroeconomic fluctuations. Financial accelerator models highlight the role of credit and asset prices in shaping the business cycle.
