Does Financial Development Absorb or Amplify the Shock?

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Abstract / Anotation

This paper analyzes the role of financial development on economic output in Indonesia. Using vector autoregressive method, the result confirms the positive impact of financial development on output growth. The interaction between the financial development and the shock in the financial or real sector show that the financial development has a positive role to dampen the negative impact of the shock on the output growth, while strengthening the positive one. Another variable in the model, which significantly affects the output growth are excess money, term of trade, and the price. Compared to these variables, the marginal effect of financial development on output is smaller.