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Bond Finance, Bank Credit, and Aggregate Fluctuations in an Open Economy*

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Abstract

Corporate sectors in emerging markets have noticeably increased their reliance on foreign financing, presumably reflecting low global interest rates. The evidence also shows a rebalancing from bank loans towards bonds. To study these developments, we develop a dynamic open economy model where these modes of finance are determined *endogenously*. The model replicates the stylized facts following a drop in world interest rates; in particular, rebalancing towards bonds occurs because bank credit becomes relatively more expensive, reflecting the scarcity of bank equity. More generally, the model is suitable for studying interactions between modes of finance and the macroeconomy.

JEL classifications: E32, E44, F41, G31

Keywords: emerging markets, corporate debt, bonds, bank credit

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