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# Sector Heterogeneity and Credit Market Imperfections in Emerging Markets

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## Highlights

- Non-tradable and tradable sectors respond asymmetrically to country interest rate shocks in EMs
- Non-tradable activities account for the negative response of GDP
- Tradable activities are not affected by changes in local credit conditions
- This asymmetric sectoral response is absent in developed open economies

## Abstract

This paper shows that the impact of country interest rate shocks on emerging markets' economic activities can be associated with credit market imperfections affecting principally non-tradable activities. I present novel evidence documenting that tradable and non-tradable activities respond asymmetrically to changes in credit conditions in emerging markets. I show that country interest rate shocks are amplified through non-tradable activities, and that local credit substantially explains their output growth. Unlike the non-tradable sector, tradable activities are not significantly affected by changes in local credit conditions. To rationalize these findings, I introduce a small open economy model with heterogeneous access to international borrowing that accounts for the asymmetric response of tradable and non-tradable activities.

*Keywords:* financial frictions, interest rate shocks, emerging markets. *JEL:* E44, F34, F41, F43.

## 1 Introduction

External shocks substantially aggregate activities in emerging markets. Changes in international

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