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Credit Decomposition and Business Cycles in Emerging Market Economies*

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Abstract

This paper analyzes the differential effects of household and business credit dynamics on business cycles in emerging market economies. We first provide evidence that existing results relating credit expansions to economic expansions, real exchange rate appreciations and trade deficits hold more strongly for household credit than business credit. Then, using a two-sector real business cycle model of a small open economy, we study the model dynamics generated by shocks to household credit and business credit, the latter further divided into credit to tradable and nontradable sectors. The results show that the three types of credit shocks generate different dynamics in sectoral input and output levels as well as the real exchange rate. The model successfully generates the comovement between the cycle and different credit types, matching the strong positive correlation of household credit with output and real exchange rate, and the negative correlation with net exports. Our results underline the importance of distinguishing between household and business credit in studying credit dynamics.

JEL classification: E32, E44, F34, F41

Key Words: Household Credit, Business Credit, Business Cycles, Credit Shocks

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