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IMF Working Paper

Cross-Border Credit Intermediation and Domestic Liquidity Provision in a Small Open Economy

by Thorvardur Tjoervi Olafsson

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I N T E R N A T I O N A L M O N E T A R Y F U N D

IMF Working Paper

Monetary and Capital Markets Department

Cross-Border Credit Intermediation and Domestic Liquidity Provision in a Small Open Economy

Prepared by Thorvardur Tjoervi Olafsson¹

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Abstract

This paper develops a small open economy model where global and domestic liquidity is intermediated to the corporate sector through two financial processes. Investment banks intermediate cross-border credit through interlinked debt contracts to entrepreneurs and commercial banks intermediate domestic savings to liquidity-constrained final good producers. Both processes are needed to facilitate development of key production inputs. The model captures procyclical investment bank leverage dynamics, global liquidity spillovers, domestic money market pressures, and macrofinancial linkages through which shocks propagate across the two processes, affecting spreads and balance sheets, as well as the real economy through investment and working capital channels.

JEL Classification Numbers: E3, E22, E44, F34, F41, G1

Keywords: financial frictions, cross-border banking flows, macrofinancial linkages, financial intermediation, working capital, credit contracts

Author's E-Mail Address: tolafsson@imf.org

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