Abstract

The Russian Default of 1998 provides a natural experiment to test how global financial linkages transmit negative credit supply shocks to emerging markets. Using bank-level data from Peru, I show that the shock affects bank lending by both foreign and domestic banks because all banks refinance their lending abroad. Using microdata on all corporate loans, I show that foreign banks reduce lending less because of a smaller reduction in foreign debt. I rule out the main alternative explanation of heterogeneous credit demand shocks of firms borrowing from foreign banks versus domestic banks by showing that the estimation is robust to estimating the effects within firms across bank relationships. I explain the differential effect by showing that domestic banks have incentives to lend to firms owned by bank owners which reduces access to foreign debt after a credit supply shock. Finally, I show that firms cannot offset the shock, leading to a lower bankruptcy rate among firms borrowing from foreign banks.

Keywords: Foreign Bank, Credit Crunch
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