Estimating the direct impact of bank liquidity shocks on the real economy: Evidence from letter-of-credit import transactions in Colombia

REVIEW OF INTERNATIONAL ECONOMICS
Número:
5
DOI:
https://doi.org/10.1111/roie.12433
Publicado:
Viernes, 23 Agosto 2019
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Clasificación JEL:
F1, F4, G1, G2
Palabras clave:
liquidity shocks, letters of credit, Imports, Global Financial Crisis
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This study identifies and provides an estimate of the impact of bank liquidity shocks on real economic activity by exploring letter-of-credit import transactions in Colombia during the 2008 to 2009 global financial crisis. The detailed dataset on letter-of-credit transactions allows for exploiting within-importer–exporter variation across issuing banks. The study finds substantial effects of bank liquidity shocks on letter-of-credit import transactions: banks that were more vulnerable to adverse liquidity shocks—proxied by the ex ante reliance on wholesale funding or borrowings from foreign banks—reduced letter-of-credit issuances more in both intensive and extensive margins. The study also confirms that it had real effects: importer–exporter pairs that relied more on letter-of-credit transactions experienced a greater reduction in their total imports in response to adverse bank liquidity shocks.

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