Foreign investment dynamics: The impact of benchmark-driven versus unconstrained investors on local credit conditions

Borsa Istanbul Review
DOI:
https://doi.org/10.1016/j.bir.2025.11.001
Publicado:
Martes, 30 Diciembre 2025
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Clasificación JEL:
F3, F4, G01, G11, G12, G15
Palabras clave:
Capital flows, Foreign investment, Investor classification, J.P. Morgan GBI-EM index, Emerging Markets
Resumen:

We examine how heterogeneity among foreign investors influences local lending, focusing on Colombia between 2014 and 2023. By differentiating between benchmark-driven and unconstrained investors, we highlight their distinct responses to global and idiosyncratic shocks. Using bond-level data and the corporate credit registry, we link banks' exposure to foreign flows with firm-level lending decisions. By decomposing Colombia's weight in the J.P. Morgan GBI-EM index into valuation-driven and exogenous components, we identify how investor behavior shapes bank balance sheets. Our main findings show that banks with greater exposure to unconstrained investors significantly expand lending during capital inflows, whereas those linked to benchmark-driven investors exhibit a more muted response. These results emphasize investor composition's role in shaping financial stability and provide key insights for policymakers in emerging markets.

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