

Value-at-Risk Constraints, Bank Heterogeneity, and Global Financial Spillovers

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Abstract

When does a foreign-rate tightening cause a large contraction in emerging economies? Bank-level evidence suggests that highly levered EME banks contract assets more sharply after periods of U.S. easing. I explore this in a small open economy model with sticky pricing and heterogeneous banks that borrow in foreign currency under a Value-at-Risk constraint embedding exchange-rate jump risk. The model illustrates how prolonged easing tilts intermediation toward high-leverage, FX-exposed intermediaries, and how a subsequent foreign-rate tightening can trigger an extensive-margin contraction that a representative-bank model misses. Numerical solutions examine the state-dependent nature of output responses across different rate baselines, providing potential implications for macroprudential tools.

Keywords: Global Financial Cycle, Heterogeneous Banks, Value-at-Risk, FX-Jump Risk, Small Open Economy, State-Dependent Amplification.

JEL classification: E44, F32, F41, G21

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