

Bank Globalization and Monetary Policy Transmission in Small Open Economies*

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Abstract

This paper investigates how the openness of the banking sector influences the transmission channels of domestic and international monetary policy shocks in small open economies. I study these relationships in a small open economy DSGE model enriched with a globalized banking sector. Two forms of bank globalization are considered: international finance of operating funds and import of foreign loan contracts. For a quantitative analysis of the channels linked to each type of bank globalization, I also construct alternative models that allow for different degrees of bank globalization. The comparison between the responses of benchmark and alternative models shows that bank globalization leads to a significant attenuation of domestic monetary policy transmission because, against domestic monetary shocks, banks' global activities help maintain bank rates and loan supplies to some extent in contrast to responses in a financial autarky. However, the opening of the banking sector intensifies the impact of foreign interest rate shocks on local bank activities. In addition to the indirect international monetary spillover through the interest-parity condition, global operation allows banks to adjust loan rates responding directly to foreign monetary shock.

JEL Classification: E32, E44, E52, E58, F36, F62

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