Abstract

Sudden Stops And Bank Competition

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JEL Classification: F41, G21

This study investigates the implications of sudden stops on the competitive landscape of the banking sector. Using data for 46 emerging economies, the study presents evidence of a reduction in banking competition following a sudden stop episode. This paper employs a small open economy model featuring banks that operate under oligopolistic competition and face an occasionally binding collateral constraint. The entry and exit of banks influence the market power of existing incumbents. The diminishing availability of external funds triggers a contraction in the banking sector, resulting in a reduced number of banks. The resulting decrease in the number of banks amplifies market concentration, empowering surviving institutions to exercise greater pricing power. The higher loan markup and increased concentration in the banking industry attenuates the consumption and investment of the economy highlighting amplification of the shock due to the presence of oligopolistic competition among banks.