

Industrial Structures, Economic Volatilities, and Collateral Constraints in Small Open Economies

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Abstract

This paper extends the Bianchi's (2011) two-sector small open economy model to evaluate the assumptions on collateral constraints in terms of an observed relationship between industrial structures and the economic volatilities. The relationship is that countries with larger shares of tradable sectors, which are often emerging or developing economies, tend to experience larger economic fluctuations. It is shown that the model is consistent with this observed fact when one assumes that the assets of tradable sectors are collateralized, while it is not when one assumes current income as the collateral.

Keywords: Asset price, Collateral constraint, Industrial structure, Real exchange rate, Small open economies

JEL classification: E32, E44, F41

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