

Keep in mind

The series Working Papers on Economics is published by the Office for Economic Studies at the *Banco de la República* (Central Bank of *Colombia*). It contributes to the dissemination and promotion of the work by researchers from the institution. This series is indexed at Research Papers in Economics (RePEc).

On multiple occasions, these works have been the result of collaborative work with individuals from other national or international institutions. The works published are provisional, and their authors are fully responsible for the opinions expressed in them, as well as for possible mistakes. The opinions expressed herein are those of the authors and do not necessarily reflect the views of Banco de la República or its Board of Directors.

AUTHOR OR EDITOR

[Franz Hamann](#)

This paper investigates the effect of sovereign risk on the stochastic rational expectations equilibrium of a real business cycle small open economy. The market is imperfect because the sovereign cannot commit to repay its outstanding debt and chooses to default when it is optimal to do so. The possibility of default induces an endogenous sovereign risk premium on foreign debt and an endogenous rationing limit set by foreign creditors. The model is parameterized and solved numerically to explore the determinants of the savings and investment decisions in an economy that can optimally choose to default on its foreign debt and the ability to account the sudden Stop of capital inflows.

---

