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Keep in mind

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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.