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Keep in mind

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This paper investigates the impact of sovereign risk on the stochastic rational expectations equilibrium of a pure exchange small open economy. International borrowing and lending arise from the interaction between a risk averse sovereign representative agent in a small open economy trying to self insure against idiosyncratic shocks and risk neutral international lenders. The credit 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 endogenous rationing by foreign creditors. The model is parameterized and solved numerically. The experiments conducted here generalize the results of Eaton and Gersovitz (1981) into environments

with varying degrees of persistence and volatility in the underlying stochastic income process.