Abstract

We estimate a system of equations to analyze whether bilateral trade and financial linkages influence business cycle synchronization directly and/or indirectly. Our paper builds upon the existing literature by using bilateral trade and financial flows for a small, open economy (Spain) as benchmark for the results, instead of the US as generally done in the literature. We find that both the similarity of productive structure and trade links promote the synchronization of cycles. However, bilateral financial links are inversely related to the co-movement of output. This might point to financial integration allowing an easier transfer of resources between two economies, which could enable their decoupling, as predicted by a standard model of international business cycles. Both the effects of trade and financial links on output synchronization are statistically significant and economically relevant.

JEL Classification: E32, F41, F12, E44.

Keywords: business cycle synchronization, trade linkages, financial linkages, productive structure, integration.

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