Abstract
Greater financial integration between core and peripheral EMU members not only had an effect on both sets of countries but also spilled over beyond the euro area. Lower interest rates allowed peripheral countries to run bigger deficits, which inflated their economies by allowing credit booms. Core EMU countries took on extra foreign leverage to expose themselves to the peripherals. We present a stylized model that illustrates possible mechanisms for these developments. We then analyze the geography of international debt flows using multiple data sources and provide evidence that after the euro’s introduction, core EMU countries increased their borrowing from outside of EMU and their lending to the EMU periphery. Moreover, we present evidence that large core EMU banks’ lending to periphery borrowers was linked to their borrowing from outside of the euro area. (JEL: F32, F34, F36)

Keywords: international debt, EMU, international banking, global imbalances, euro crisis.