

How Do Banks Propagate Economic Shocks?

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Abstract:

This paper exploits the COVID-19 pandemic as a negative shock on firm revenues and studies the transmission of this shock across industries via banks. We use the ex-ante heterogeneity in the amount of loans issued to affected industries to measure the variation in banks' exposure to the negative shock. Using bank-firm level credit register data from Turkey, we show that banks transmitted the shock by decreasing their loan supply not only to affected but also to unaffected industries. The effect persists at the firm level, yet lower for large firms and for firms with an existing relationship to state-owned banks.

Keywords: Bank loan supply; Economic shock propagation; COVID-19 pandemic; Bank lending channel; Firm borrowing channel

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