Macro Roundup Artcile

Headline: Do Banks Lend to Distressed Firms?

Article Link: https://www.frbsf.org/economic-research/publications/economic-letter/2023/november/do-banks-lend-to-distressed-firms/

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Tweet: Banks lend to firms to help them recover sunk costs. Between 2014-19, bank lending to zombie firms reduced economy-wide productivity by 0.25%. @mfariacastro @vediense @pascalpaul

Summary: Our study builds on an intuitive idea: to recover its past investment, a lender has incentives to offer more favorable lending terms to a firm close to default to keep the firm alive. In contrast to standard intuition, we find that evergreening allows a firm with worse fundamentals—less productive and with more debt—to borrow at relatively better terms. Based on detailed U.S. loan-level data for the years 2014-19, we provide empirical support for our theory at a time when the banks were relatively well capitalized and the economy was growing steadily. Using a dynamic model of the U.S. economy, we find that evergreening has material effects on the performance of the overall economy, resulting in lower borrowing rates, higher levels of debt, and depressed overall productivity. Related: The Grind Ahead and 40% of Companies in Russell 2000 Have Negative Earnings and Rates Are Up. We're Just Starting to Feel the Heat

Primary Topic: Growth

Topics: Banking, GDP, Growth, Monetary Policy, Op-Ed/Blog Post

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