Scarring and Corporate Debt

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This paper estimates the scarring effect of recessions on corporates’ investment and how it is amplified by the level of corporate debt. Our results suggest that the effect of firms’ debt in shaping the response of investment to recessions is statistically significant and economically sizeable, with high debt firms seeing a larger decline in investment than low debt firms. Back-of-the-envelope calculations suggest that firms’ debt accounts for at least 28 percent of the average medium-term decline of investment following a recession. This effect is especially larger for firms that are credit constrained—small and less profitable firms, as well as firms with high share of short-term debt—and that therefore may find it more difficult to rollover or raise new funds to invest in new projects. The results are robust to several checks, including to various sub-samples, alternative measures of recessions and explanatory variables, and a large set of controls.

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