Week 6 Ideas

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May 9, 2025

Idea 1. Conceptual clean estimation of credit crowding out effect

According to the paper Pinardon-Touati (2025), the crowd out effect of local government borrowing on the real output is conceptually transmitted in the following chain. (i) The increased government credit demand will lead to decreased firm credit supply, within the bank sector; (ii) The decreased firm credit supply will lead to the decreased real investment; (iii) The decreased real investment aggregates to the decreased total output.

This type of literature reminds me of the credit supply in the banking literature. For example, Cortés and Strahan (2017) studies the change in credit supply in the US residential mortgage market after natural disasters. Probably a cleaner way to estimate the government credit crowding out effect is to find a more exogenous shock happening to the economy, such as a natural disaster with the immediate increase in government credit demand.

What's more, according to the equilibrium analysis, the quantity of the crowd-out effect depends on the elasticity of credit demand. Although the paper usually assumes the total supply does not change if it is actually fixed, then the mechanism should be that the increased amount of government credit leads to the increase in total credit demand, and therefore the equilibrium borrowing interest rate is higher, and therefore firm want to borrow less.

If we can observe better loan contract data, probably a better way to estimate the crowd-out effect is to estimate the credit demand elasticity and then derive the effect. There is loan

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contract level data, such as dealscan or other bank-firm loan contract level data, where we can directly observe the borrowing interest rate/borrowing cost. Then we can verify whether the borrowing cost increases or does not increase after the government credit demand increases. In this way, the credit crowding out effect will be cleaner.

Idea 2. Effect of Securitization on Credit Supply

Securitization is a type of financial tool for financial institutions to package multiple loans as securities to sell on the secondary market. Theoretically, by securitization, the loan institutions shift the credit/default risk to the secondary market investors and therefore they could create a new credit supply. The channel of the secondary market investors is sometimes referred to as the shadow banking channel.

It would be interesting to first study how much securitization creates a new credit supply in the banking sector and shadow banking sectors. Especially, it would be increasing to see, at the bank level, whether securitizations lead to more non-securitization loans. The data is available from the RMBS or CMBS data vendors such as Morningstar or Trepp.

References

Cortés, Kristle Romero, and Philip E. Strahan, 2017, Tracing out capital flows: How financially integrated banks respond to natural disasters, *Journal of Financial Economics* 125, 182–199.

Pinardon-Touati, Noémie, 2025, The Crowding Out Effect of Local Government Debt: Micro- and Macro-Estimates .