

Real Effects of Financial Distress: The Role of Heterogeneity

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Sudipto is an economist in the research department of the Bank of Portugal. Sudipto's work mainly relates to macroprudential policy, real-financial sector linkages & reallocation/misallocation of resources.

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[Abstract]: How severe are the real consequences of financial distress caused by the sovereign debt crisis? What are the channels through which sovereign debt crisis affects banks and firms? Does firm heterogeneity matter? If yes, what are the important dimensions of heterogeneity? Using micro data from Portugal during the sovereign debt crisis, starting in 2010, we address these questions. We make use of the Bank of Portugal's detailed credit registry database together with bank and firm balance sheets and income statements to conduct this analysis. We first study the direct effect of the sovereign debt crisis on bank balance sheets by analyzing the differential impact on firms that had relations with banks who were more exposed to the sovereign (pre-crisis). We find that more fragile firms that had relations with more exposed banks contracted more than their counterparts. Specifically, we find leverage and maturity structure of debt to be important dimensions of heterogeneity determining a firm's fragility. Highly leveraged firms and those that had a larger share of short term debt contracted more during the sovereign debt crisis. We analyze firm performance on the basis of growth rate of employment, assets, liabilities and usage of intermediate commodities. We then document the spillover effects across firms that are mediated through the banking sector. To do this, we focus on the set of firms that were in good standing on all their loans through the crisis, i.e., the set of performing firms. We find that the performing firms that had relations with banks whose corporate loan portfolio deteriorated by more were more affected by the crisis. Again, leverage and the maturity structure of debt appear to be important dimensions of form heterogeneity. Lastly, we show that our findings are consistent with a simple model of leverage and maturity choice under credit shocks.