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When Credit Bites Back

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Abstract

Using data on 14 advanced countries between 1870 and 2008 we document two key facts of the modern business cycle: relative to typical recessions, financial crisis recessions are costlier, and more credit-intensive expansions tend to be followed by deeper recessions (in financial crises or otherwise) and slower recoveries. We use local projection methods to condition on a broad set of macro-economic controls to study how past credit accumulation impacts key macro-economic variables such as output, investment, lending, interest rates, and inflation. The facts that we uncover lend support to the idea that financial factors play an important role in the modern business cycle.

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