Accepted Manuscript

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PII: S0261-5606(17)30137-7
DOI: http://dx.doi.org/10.1016/j.jimonfin.2017.07.016
Reference: JIMF 1820

To appear in: Journal of International Money and Finance

Please cite this article as: S. Choi, D. Furceri, Y. Huang, P. Loungani, Aggregate Uncertainty and Sectoral Productivity Growth: The Role of Credit Constraints, Journal of International Money and Finance (2017), doi: http://dx.doi.org/10.1016/j.jimonfin.2017.07.016

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Aggregate Uncertainty and Sectoral Productivity Growth: The Role of Credit Constraints

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March 2017

Abstract

We show that an increase in aggregate uncertainty—measured by stock market volatility—reduces productivity growth more in industries that depend heavily on external finance. The mechanism at play is that during periods of high uncertainty, firms that are credit constrained switch the composition of investment by reducing productivity-enhancing investment—such as on ICT capital—which is more subject to liquidity risks (Aghion et al., 2010). The effect is larger during recessions, when financing constraints are more likely to be binding, than during expansions. Our statistical method—a difference-in-difference approach using productivity growth of 25 industries from 18 advanced economies over the period 1985-2010—mitigates concerns with omitted variable bias and reverse causality. The results are robust to the inclusion of other sources of interaction effects, instrumental variable approaches, and different datasets. The results also hold if economic policy uncertainty (Baker et al., 2016) is used instead of stock market volatility as a measure of aggregate uncertainty.

Keyword: productivity growth; financial dependence; uncertainty; Information and communication technology investment.

JEL codes: E22; F43; O30; O47.

\* We have benefited from comments by an anonymous referee, and discussions with Hie Joo Ahn, Jess Benhabib, Nick Bloom, Menzie Chinn, Roger Farmer, Laurent Ferrara, Gee Hee Hong, Brandon Julio, Weicheng Lian, Zheng Liu, Gabriel Mathy, Simon Sheng, Aaron Tornell, and Michael Waugh. We are thankful to seminar participants at the 2nd Workshop on Uncertainty (London), 2016 Melbourne Institute Macroeconomic Policy Meetings (Melbourne), American University, AFR Summer Institute of Economics and Finance Conference (Hangzhou), International Monetary Fund, UCLA, and the Bank of Korea (Washington, D.C.). The views expressed in this paper are those of the authors, and not necessarily those of the International Monetary Fund.

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