Accepted Manuscript

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PII: S0378-4266(17)30103-6
DOI: 10.1016/j.jbankfin.2017.05.001
Reference: JBF 5139

To appear in: *Journal of Banking and Finance*

Received date: 11 November 2015
Revised date: 28 April 2017
Accepted date: 2 May 2017

Please cite this article as: Fabián Valencia, Aggregate Uncertainty and the Supply of Credit, *Journal of Banking and Finance* (2017), doi: 10.1016/j.jbankfin.2017.05.001

Aggregate Uncertainty and the Supply of Credit

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May 5, 2017

Abstract

This paper presents a model in which a bank can exhibit self-insurance with loan supply contracting when uncertainty increases. This prediction is tested with U.S. commercial banks, where identification is achieved by looking at differential effects according to banks' capital-to-assets ratio (CAR). Increases in uncertainty reduce the supply of credit, more so for banks with lower levels of CAR. These results are weaker for large banks, and are robust to controlling for monetary policy, to different measures of uncertainty, and to breaking the dataset in subsamples. Quantitatively, the effect of uncertainty on credit supply is about as important as monetary policy.

JEL classification: E5, E44, D80

Keywords: Credit Cycles, Credit Crunch, Uncertainty, Self-insurance.

*The author thanks Geert Bekaert (the editor), Stijn Claessens, Giovanni Dell'Ariccia, Giovanni Ferri, Leonardo Gambacorta, Randall Kroszner, Luc Laeven, two anonymous referees, and seminar participants at the IMF, the Legatum Institute, the 2013 MoFir workshop, the 2013 Society for Economic Dynamics meetings, the 2015 Spring Midwest Macro meetings, and the 2015 Georgetown Center for Economic Research biennial conference for comments and discussions and Jeanne Verrier for outstanding research assistance. The views expressed in this paper are those of the author and do not necessarily represent those of the IMF or IMF policy. Phone: 202-623-6355. Mailing address: 5459 Whitley Park Terrace, Bethesda, MD 20814.