Credit Conditions, Labor Markets and Economic Outlook

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Is there a credit crunch? Will there be one?

- H8, Beige Book, SLOOS, all show credit tightening
  ⇒ most from mid-sized banks between 50-250 billion in assets

- **Impossible to know which firms will get hit most** (employment, investment) without 
  **firm-bank matched data**

- **Critical issue**: what happened in Q1 to lending by systemically important banks (FR Capital 
  Assessments and Stress Testing—CCAR).
  ⇒ Provide 65 percent of C&I lending as of now
  ⇒ Provided 70 percent of C&I lending before 2020
  ⇒ CCAR Banks > 100 billion in assets (some in 100-250b are dropped after 2020)
We need to know the following to predict the effect of current banking stress on real economy

- Who borrows from who?
  $\Rightarrow$ SMEs borrow from big banks

- What part of the real economy is vulnerable to hikes in rates? Are these firms’ main constraints "earnings-based" or "asset-based"? (transmission channels).
  $\Rightarrow$ Small firms and leveraged firms; earnings-based constraints outside construction (CRE)

- Was credit boom accompanied by investment boom in commercial real estate and construction?
  $\Rightarrow$ No

- Quantitative importance of credit demand in a strong economy with tight labor markets.
  $\Rightarrow$ In the absence of a systemic econ-wide banking crisis, credit demand is more important than credit supply for monetary policy transmission
Who borrows from who?
Bank dependent firms account more than 60 percent of aggregate employment
Leveraged firms’ and SMES affected more from tighter monetary policy

Leveraged Firms Loan Response

SMEs Sales Response

Percentage Points Change

Quarters

Percentage Points Change

Quarters
Debt Growth and Leverage by Firm Size

(a) Debt

(b) Leverage
Tight/Low Credit: Disinflationary or Inflationary? Depends on credit demand vs credit supply

- If there is econ-wide banking crisis/credit crunch (as 2008), then disinflationary

- If not, tighter lending standards/credit rationing can be inflationary conditional on credit demand being strong from firms using high value real estate collateral (lower cost of funds) and higher earnings

- If tight credit only applies for commercial real estate and construction (clients of regional banks), what matters is whether credit boom went together with investment boom. ⇒ Investment in these sectors still below pre-COVID trend.
Why disinflation is slow? Why labor market is resilient? The role of demand-supply imbalance in labor markets by sector.

(a) Headline

(b) Core

(c) Services

(d) Goods
Segmented Labor Markets, Labor Supply Shock and Inflation

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- $L_f$: Equilibrium employment
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- During recovery – point D: heterogeneous across sectors, may not be back to 2019, still inflationary)
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Sources of Inflation in US, 2019–2022, avg inflation 7.6

Model-Based Inflation
Aggregate Demand
Sectoral Demand

Inflation, %

- Model-Based Inflation: 9.18
- Aggregate Demand: 6.33
- Sectoral Demand: 3.08