

Fiscal policy and lending relationships

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This paper studies how fiscal policy affects credit market conditions. First, it conducts a FAVAR analysis showing that the credit spread responds negatively to an expansionary government spending shock, while consumption, investment, and lending increase. Second, it illustrates that these results are not mimicked by a DSGE model where the credit spread is endogenized via the inclusion of a banking sector exploiting lending relationships. Third, it demonstrates that introducing deep habits in private and government consumption makes the model able to replicate empirics. Sensitivity checks and extensions show that core results hold for a number of model calibrations and specifications. The presence of banks exploiting lending relationships generates a financial accelerator effect in the transmission of fiscal shocks.

Keywords: Fiscal policy, deep habits, credit spreads, lending relationships.

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