The Anatomy of a Credit Crunch

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Abstract
What are the micro and macro implications of a credit crunch? We study this question in a model where heterogeneous entrepreneurs can finance their investment by borrowing subject to collateral constraints and/or by using internal funds. We discipline our theory by requiring that the size distribution and the dynamics of establishments in the model match those in the US data. We model a credit crunch in two complementary ways: (1) an unanticipated and temporary tightening of the collateral constraint; (2) an unanticipated and temporary increase in the wedge between deposit and lending rates. We show that a credit crunch has substantial impact on the size distribution and the dynamics of establishments, as well as on aggregate TFP and investment. In particular, the effects of a credit crunch differ significantly from those of exogenous TFP shocks. We compare our model predictions with the observed dynamics of establishments in the US during recessions to determine whether credit shocks are the main driving force behind aggregate fluctuations.

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