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The Impact on Economic Activity of Asset Allocation and Credit Conditions at Small Banks

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Poster Presentation P2

**THE IMPACT ON ECONOMIC ACTIVITY OF ASSET ALLOCATION AND
CREDIT CONDITIONS AT SMALL BANKS**

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This study is directed towards the effects of bank capital pressures, asset allocation, and other economic shocks on the performance of economic activity. I estimate the effect of these factors on employment, payrolls, and number of firms by firm size in the United States. One conclusion is that banks reduced their total supply of bank credit after loan losses reduced their capital levels. A number of former studies arrive at this conclusion, and this paper applies that hypothesis to more recent data. Another common theme in the literature is that a “credit crunch” causes particular stress on small businesses because of their heavy reliance on external financing, which is mainly provided by small local and regional banks. Small banks have historically been thought to have special ties to small businesses, and with the consolidation of the largest banks (and subsequent focus on relationships with the largest businesses) over recent years, this study reveals how the relationship between small banks and small businesses has increased. Using small, medium, and large bank data from 1997 to 2006, this study finds that real activity is affected by variations in bank credit conditions and that businesses that were more “bank dependent” responded more to conditions in the banking sector.