COVID-19, Policy Interventions and Credit: The Brazilian Experience

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Abstract

The COVID-19 pandemic caused a global health and economic crisis to which governments responded with massive policy interventions. Using Brazil as a testing ground, we investigate the influence of the pandemic and ensuing policy interventions on local credit markets. First, we find that the pandemic has a significantly negative impact on local credit. Second, using a novel manually collected database on the staggered municipal government policy interventions, we show heterogeneous effects of interventions: positive effects of soft interventions (e.g., social distancing and mass gathering restrictions) and negative effects of hard interventions (e.g., closure of non-essential services) and early reopening. Third, we find that state-owned banks grant more local credit than privately owned banks during the COVID-19 crisis, but this difference is less pronounced than it was in the 2008 Financial Crisis. We confirm our results using pre-pandemic local political preferences as instrument for policy interventions and orthogonalized policy intervention indicators, and in placebo tests.

Hypothesis

Hypothesis 1. The COVID-19 pandemic has a negative impact on local credit.

Hypothesis 2. Policy interventions have heterogeneous effects on local credit during the COVID-19 pandemic. Soft interventions (social distancing, mass gathering restrictions and closure of non-essential services) have a positive effect (H2a), hard interventions (closure of public services and/or non-essential services) have a negative effect (H2b), and the reversal of restrictive policy interventions (reopening) has a positive effect (on local credit during the pandemic (H2c).

Hypothesis 3. Local credit during the COVID-19 crisis is driven by state owned banks.

Data sources

We collect the following data from Jan 2018 to Sep 2020:  
- COVID-19 data (new cases and deaths) from the Ministry of Health of Brazil  
- Policy intervention data: hand-collected for 2012 metropolitan municipalities from local legislative decree, official notices (Gazeta Oficial) and public health journals  
- Bank data (bank loans quality level) - ESTAB data for all commercial banks from Central Bank of Brazil (Bacen)  
- Local political and economic data: local political preferences (as instrumental variables) from the Superior Electoral Court of Brazil, IBGE data, CAGED data, and IDE

Methodology

The main method used involves an OLS regression, which is applied to monthly data. To deal with endogeneity and possible reverse causality, we use policy intervention variables as instruments. To control for possible omitted variables, we perform placebo tests.

Further checks and robustness tests

We investigate whether the effect of local policy intervention on local credit is robust to changes in the unevenness of political preferences across local governments. To control for potential reverse causality, we use placebo tests. To control for possible omitted variables, we perform placebo tests.

Conclusions

We find that the pandemic causes a significant negative impact on local credit. We also find that state-owned banks grant more local credit than privately-owned banks during the COVID-19 crisis, but this difference is less pronounced than it was in the 2008 Financial Crisis. The evidence suggests close policy implications.