

COVID-19 and Credit Reallocation: evidence from Brazil

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Abstract

This study examines the reallocation of credit to less risky clients by banks across Brazilian municipalities in response to the COVID-19 pandemic, employing a difference-in-differences (DiD) approach. We leverage the heterogeneous timing and intensity of COVID-19's impact on Brazilian cities to establish causality. Additionally, we investigate bank characteristics associated with a more pronounced credit reallocation, including bank size, control structure, and capital indices. Our findings reveal a bank credit portfolio reallocation toward clients in inland cities, where the impact of the Pandemic was less significant when compared with Brazilian state capitals. Branches of inland cities with highly concentrated local credit markets where large banks dominate, and total outstanding credit is relatively underdeveloped had a more pronounced credit shift. Our results evidence that the bank financing channel did not cushion the effects of COVID-19 in the real economy, potentially becoming a pro-cyclical component.

Keywords: COVID-19, portfolio reallocation, credit growth, banking, econometrics, financial stability.

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