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Trade credit, sovereign risk and monetary policy in Europe

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TRADE CREDIT, SOVEREIGN RISK AND MONETARY POLICY IN EUROPE

ABSTRACT

The purpose of this article is to analyze how sovereign risk influences the use of trade credit, both directly and through monetary policy. In addition, we test whether these effects differ during the crisis as compared to before the crisis. Using a sample of 45,864 Eurozone firms (2005–2012), we find that trade credit received increases when sovereign risk becomes higher, but only before the crisis. However, during the crisis, trade credit supply decreases as sovereign risk increases. Additionally, monetary restrictions only lead to an increase in trade credit in low or moderate sovereign risk countries.

Keywords: Trade credit; Sovereign risk; Monetary policy.

JEL Classification: E44, E52, G32.

1. INTRODUCTION

Monetary policy exerts its influence through several channels, which include the interest rate effects, exchange rate effects, other asset price effects, and the credit channel (Mishkin, 1995). The credit channel includes a mechanism called the trade credit channel, which highlights the importance of trade credit as an alternative source of funding. According to this channel, when monetary policy tightens and funding from financial institutions declines, firms increase their use of trade credit (Meltzer, 1960; Kohler et al., 2000; Nilsen, 2002; Mateut et al., 2006). In this context, the less financially vulnerable firms canalize sources of funding by extending trade credit to firms rationed by financial intermediaries. Thus, trade credit can be an important source of finance when there is shortage of bank credit, in that it helps in alleviating the financial constraints on firms.

Since the onset of the financial crisis, there has been a growing concern for the impact of sovereign risk on financial intermediaries, their balance sheets, and their ability to grant credit. Greater sovereign risk increases the cost and reduces the availability of some euro area bank funding, which leads to a sharp reduction in the supply of bank loans (CGFS, 2011; Bofondi et al., 2013; Albertazzi et al., 2014;

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