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The Real Effects of Credit Crunch in the Great Recession: Evidence from Italian Provinces*

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Abstract. The paper estimates the real effects of the sharp reduction in credit supply, following the 2008 financial crisis, on Italian local economies. We develop a measure of local credit supply that is based on the market shares of the banks that serve a local economy and the national change in each bank's lending that is attributable to supply factors (i.e., purged of local demand factors). The decrease in our credit supply indicator, which is strongly correlated to the outstanding loan dynamics, explains the 13% of the contraction in real value added with respect to the pre-crisis period. The negative effects on the value added are heterogeneous across sectors and, in particular, are larger for the manufacturing sector. Moreover, the impact of the credit crunch is concentrated on the small firms, in the areas that are more dependent upon external finance and in the Central-Northern provinces. Finally, credit supply shocks affected lending but not real outcomes in the pre-crisis period.

Keywords: Credit crunch, economic crisis, local growth.

JEL classification: E51, G21, R11.

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