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# Corporate balance sheet adjustment: stylized facts, causes and consequences

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Deep economic crises are associated with stress in public and private sector balance sheets and they are often followed by protracted periods of balance sheet adjustment. However, while economists have recently spent much time assessing sovereign debt and the financial health of banks, balance sheets of non-financial corporations have been subject to less scrutiny. This paper analyses the causes and macroeconomic consequences of balance sheet adjustment processes in the non-financial corporate sector.

Balance-sheet adjustment can be captured at a macroeconomic level by changes in corporate net lending or borrowing (NLB). Corporate NLB measures corporations' net needs in terms of external finance. A large reduction in the demand for external finance leads to an adjustment of balance sheets. In the euro area, corporate NLB increased significantly following the downturn of the early 2000s and the global economic crisis has also left a strong footprint on euro-area corporate net lending. Similar cyclical developments can be observed in the US where corporate net lending has remained firmly in positive territory since the global financial crisis. Changes in NLB have effects of macroeconomic relevance by impacting savings as well as investments. These corporate NLB changes are typically not fully offset in other sectors, leading to changes in the external borrowing of the country.

A better understanding of these patterns will inform policy makers regarding the speed and shape of recoveries. Moreover, corporate balance sheet adjustment has been an important driver of current account surpluses in some euro-area Member States over the past decade. Understanding the determinants of corporate balance sheet adjustment is therefore critical for a better understanding of the factors driving current account divergences within the euro area.

Based on a combination of case study and panel econometrics, this paper analyses the typical pattern of corporate balance sheet adjustment episodes, their main drivers and their macroeconomic impact. More specifically, two important episodes of balance sheet adjustment in the recent history namely Japan in the 1990s and Germany in the early 2000s are analyzed. The pattern of typical balance sheet adjustment episodes is then analyzed in a sample of 30 countries. Finally, an econometric analysis aims to detect the main drivers of past episodes of balance sheet adjustment.

The evidence presented shows that corporate balance sheet adjustments have very large and significant effects on wages, investment, savings, current accounts and corporate balance sheets themselves. Indeed, corporate balance sheet adjustments also have strong income effects as they are associated with persistent periods of wage moderation. Corporate balance sheets are thus adjusted by reducing investment and increasing savings on the back of falling

labour cost, with the latter channel of adjustment being at least as large as the former. Corporate balance sheet adjustment is found to be associated with significant decreases in leverage and debt as well as sizeable increase in liquidity held by corporations. As regards the drivers of adjustment, we find that balance sheet adjustment processes are triggered by macroeconomic growth downturns as well as high debt, low liquidity of the corporate sector and falling stock markets.