



# Weakness of investment in Portugal: what role do credit supply and fiscal consolidation shocks play?

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## Abstract

In order to illustrate how tightened financial conditions have hampered investment in Portugal, we estimate a Factor Augmented Vector Autoregressive model (FAVAR) with Bayesian techniques. We extract a financial conditions indicator and identify credit supply, demand and fiscal consolidation shocks with sign restrictions. We show that changes in financial conditions, which result from both credit supply shocks and fiscal shocks, have a protracted impact, especially on bank loans and bank lending spreads. We then develop a scenario in which the tightening in financial conditions in the wake of the sovereign crisis is attributed to credit supply shocks. The analysis suggests that, due to the crisis, by the end of 2017, Portuguese GDP, corporate investment and corporate loans were reduced by respectively 6, 22 and 20 p.p., public investment by 1 p.p. of GDP and bank lending spreads widened by 80 b.p.

**Keywords** Corporate investment · Public investment · Financial indicators · Activity · Cost of financing · Bank loans · FAVAR model · Bayesian estimation · Sign restrictions · Scenario analysis · Sovereign stress · Demand shock · Credit shock · Fiscal consolidation

**JEL Classification** C32 · C11 · E22 · E60 · G21

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