



Halle Institute for Economic Research  
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# IWH Research Seminar in Economics

November 26, 2018, 13.45pm – 15.15pm, conference room, ground floor



## “Inspect what you expect to get respect?” Can bank supervision kill zombie lending?

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(together with Diana Bonfim, Bank of Portugal and Católica-Lisbon School of Business and Economics; Hans Degryse, KU Leuven and CEPR and Steven Ongena, University of Zurich)

A bank in poor financial shape may have incentives to maintain a lending relationship with a “zombie” firm in order to avoid or delay the recognition of credit losses. In spite of growing regulatory pressure, there is evidence that “zombie lending” remains widespread in developed countries. We exploit information on a unique series of special on-site inspections of bank credit portfolios in Portugal to investigate how such inspections affect banks’ future lending decisions. We find that following an inspection a bank becomes 3 to 6 percentage points less likely to refinance a firm with negative equity. Our findings suggest that banks change their lending decisions in response to the threat of future inspections, and thus internalize the costs associated with such inspections.

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