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When good investments go bad: The contraction in community bank lending after the 2008 GSE takeover[☆]

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ABSTRACT

In September 2008, the government-sponsored enterprises (GSEs), Fannie Mae and Freddie Mac, were placed into conservatorship. The GSEs' equity prices dropped considerably in response, and, as a result, many banks that held sizable amounts of the preferred stock of the two GSEs recognized substantial losses. Fifteen failures and two mergers resulted. We treat these losses as plausibly exogenous, unanticipated, supply-side shocks to bank lending, as they are likely unrelated to demand-side factors that could affect lending, and because GSE investments were considered to be safe by banks, regulators, and rating agencies. As a result, this event allows us to examine the relationship between community bank condition and lending during the global financial crisis. We find that, following the shock, loan growth at exposed banks was about 2 percentage points lower than other banks.

☆ The views expressed in this paper are those of the authors only, and should not be interpreted as reflecting the views of the Federal Reserve Board of Governors, its staff, or the Federal Reserve System. We are grateful to Paul Merski at ICBA for sharing his expertise on the GSE event and to William Francis for his helpful advice and support of this project. We acknowledge the helpful comments of Phil Strahan, Scott Frame, Diana Hancock, Nada Mora, Linda Miles, Wayne Passmore, Richard Rosen, Steve Sharpe, Ioan Voicu, David C. Smith and seminar participants at the Federal Reserve's System Committee Meeting on Financial Structure and Regulation, the Office of the Comptroller of the Currency, the Federal Reserve Board, the FMA Annual Meetings and the ASSA Annual Meetings

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