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Abstract

We study the effect of a credit supply shock on the performance of Colombian firms, induced by an unexpected increase in the liquidity of banks. The increased liquidity was the result of sudden sell-off of Colombian government bonds by banks in response to an unexpected increase in their demand. The shift in demand for these government bonds followed the unexpected increase of its share in the composition of a prominent JP Morgan index. We exploit the variation in liquidity across banks and their preexisting relationships with firms at the time of the shock to extract from the data the variation in loans that was driven by the exogenous shock. We then connect this variation in loans to the performance of firms. We find that the positive credit shock led to increased sales by firms, based mainly on increases of capital investment.