Dynamics of Secured and Unsecured Debt over the Business Cycle

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Summary

This paper studies corporate debt structure over the business cycle and its implications for aggregate macroeconomic dynamics. We develop a tractable macro-finance model featuring debt heterogeneity with both secured and unsecured debt. Unlike secured debt, unsecured debt gives the lenders no access to the borrowers' assets in the event of default, and borrowers keep their assets at the cost of losing future access to the unsecured debt market. The difference in the nature of debt contracts leads to different risk taking behavior in the two debt markets. Our model generates strongly procyclical unsecured debt and weakly procyclical secured debt, in line with the stylized facts in US data. Moreover, we show that the inclusion of heterogeneous debt structures creates additional amplification effects relative to Bernanke, Gertler and Gilchrist (1999).