

INTEREST RATE SPREADS, CREDIT CONSTRAINTS
AND INVESTMENT FLUCTUATIONS

ABSTRACT

We present a simple framework that incorporates a role for "interest rate spreads" in models of investment fluctuations. Formally, we develop a simple model of investment and financial contracting under asymmetric information that can be used to generate an Euler equation describing firms' intertemporal decisions about investment. The Euler equation is then estimated using data on U.S. producers' durable equipment investment. We find that during certain periods -- owing to agency-cost problems -- the basic Euler equation is violated, and shifts in interest rate differentials help predict investment. Thus, the empirical results lend support to models emphasizing how: (i) movements in agency costs of external finance can amplify investment fluctuation, and (ii) changes in the interest rate spread may signal movements in these agency costs.

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