Crossing the Credit Channel: Credit Spreads and Firm Heterogeneity

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How does the cost of external finance respond to monetary policy surprises in the cross-section of firms? Does the effect depend on firms' financial position? The answers to these questions are crucial for policy-makers as they can be informative about the aggregate nature of the monetary policy transmission mechanism.

In this paper, we provide evidence on the heterogeneous impact of monetary policy on credit spreads, exploiting a large data set that merges detailed information on corporate bonds issued by US non-financial firms with information about their balance sheets.

We show that a monetary policy tightening leads to an increase in credit spreads and a contraction in firm-level debt and investment. We also show that these effects are larger for firms that have high leverage. That is: the aggregate transmission of monetary policy to credit spreads and investment is driven by firms that are likely to be relatively more financially constrained.

We interpret our results as being supportive of a credit channel view of monetary policy transmission, where financial frictions are crucial to understand the transmission of monetary policy both in the aggregate and in the cross-section.

Moreover, as the recent theoretical literature on the monetary policy transmission mechanism has focused on the role of heterogeneity, we hope that the new facts the we document in this paper could be useful to guide the choice and parametrization of macroeconomic models for policy-making.