

[Monetary Policy, Firm Heterogeneity, and Product Variety](#)

CFM-DP2021-02

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This study provides new insights on the allocative effect of monetary policy. It shows that contractionary monetary policy exerts an important reallocation effect by cleansing unproductive firms and enhancing aggregate productivity. At the same time, however, reallocation involves a reduction in the number of product variety that is central to consumer preferences and hurts welfare. A contractionary policy prevents the entry of new firms and insulates incumbent firms from competition, reducing aggregate productivity. Under demand uncertainty, the gain of the optimal monetary policy diminishes in firm heterogeneity and increases in the preference for product variety. We provide empirical evidence on US data that corroborates the relevance of monetary policy for product variety resulting from firm entry and exit.