Credit Supply, Firms, and Earnings Inequality*

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Abstract

We study the effect of a firm-level credit supply shock on the distribution of pay and employment across workers. To this end, we first construct a novel dataset that links individual employment histories to firms’ bank-credit relationships in Germany. We then use firms’ differential exposure to negative monetary policy rates through their preexisting banking relationships as a source of variation in credit supply. We find that within firms that experience a negative credit supply shock, previously lower-paid workers are more likely to be fired, while previously higher-paid workers are more likely to have their wages cut. As a consequence, wage inequality within affected firms drops. Our results suggest that monetary policy can have important distributional consequences by having heterogeneous effects on firms’ credit, pay, and employment decisions.

Keywords: Credit Supply, Monetary Policy, Negative Interest Rates, Wage Inequality, Bank Relationships, Worker and Firm Heterogeneity, Linked Employer-Employee Data

JEL Classification: D22, G21, G31, G32, J31

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