Employment and the Collateral Channel of Monetary Policy

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16th December 2018

Abstract

This paper uses a detailed firm-level dataset to show that monetary policy propagates via asset prices through corporate debt collateralised on real estate. Our research design exploits the fact that many small and medium sized firms use the homes of the firm's directors as a key source of collateral, and directors' homes are typically not in the same region as their firm. This spatial separation of firms and firms' collateral allows us to separate the propagation of monetary policy via fluctuations in collateral values from that via demand channels. We find that younger and more levered firms who have collateral values that are particularly sensitive to monetary policy show the largest employment response to monetary policy. The collateral channel explains a sizeable share of the aggregate employment response.

*We are grateful for helpful comments to Andy Blake, Giancarlo Corsetti, V.V. Chari, Simon Gilchrist, Erik Hurst, Sebnem Kalemli-Ozcan, Greg Kaplan, Fred Malherbe, Silvia Miranda-Agripinno, Michael McMahon, Ricardo Reis, Adam Szeidl, Harald Uhlig, Gianluca Violante and Jasmine Xiao. We also thank discussants and seminar participants at the 2018 CEBRA workshop, the 2018 NBER Summer Institute, the Barcelona Graduate School of Economics, the 2018 AEA Meetings, the Sciences Po Workshop on Empirical Monetary Economics, the 2017 RES Conference, the CCBS Chief Economists' Workshop, and the 2017 CCBS-MacCalm Macro-finance Workshop. Bahaj: saleem.bahaj@bankofengland.co.uk; Foulis: angus.foulis@bankofengland.co.uk; Pinter: gabor.pinter@bankofengland.co.uk, Bank of England and Centre for Macroeconomics. Surico: psurico@london.edu, London Business School and CEPR. Surico gratefully acknowledge financial support from the European Research Council (Consolidator Grant Agreement No. 647049). This paper contains the views of the authors and not necessarily those of the Bank of England, the MPC, the FPC or the PRA.