# Firm entry, credit availability and monetary policy

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**Abstract**

This paper presents a dynamic general equilibrium model that incorporates firm entry under credit rationing. Goods-producing firms in this model are bank dependent in the sense that they have no choice but to borrow funds from banks to cover labor wages that must be paid in advance of production. The results show that a cut in the policy rate enhances firm entry by mitigating the severity of credit rationing. This policy transmission is different from the conventional balance-sheet channel in that a change in the policy rate directly affects borrowers' credit availability. I also show that a sudden stop in the credit supply to new firms is most likely to occur shortly after a credit boom. This is because endogenous downward wage rigidity prohibits the credit risk of prospective firms from decreasing enough to re-equilibrate the loan market.

*JEL Classification*: E32, E44, E52

*Keywords*: credit channel, credit crunch, credit rationing, firm entry, monetary policy transmission.

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