

**Monetary Policy, Business Fluctuations
and The Behavior of Small Manufacturing Firms**

Abstract

We present evidence on the cyclical behavior of small versus large manufacturing firms, and on the response of the two classes of firms to monetary policy. Our goal is to take a step toward quantifying the role of credit market imperfections in the business cycle and in the monetary transmission mechanism. We find that, following tight money, small firms sales decline at a faster pace than large firm sales for a period of more than two years. Further, bank lending to small firms contracts, while it actually rises for large firms. Monetary policy indicators tied to the performance of banking, such as M2, have relatively greater predictive power for small firms than for large. Finally, small firms are more sensitive than are large to lagged movements in GNP. Considering that small firms overall are a non-trivial component of the economy, we interpret these results as suggestive of the macroeconomic relevance of credit market imperfections.

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