

## **Abstract**

This paper analyzes the propagation of monetary policy shocks through the creation of credit in an economy. Models of the monetary transmission mechanism typically feature responses that last for a few quarters contrary to what the empirical evidence suggests. To propagate the impact of monetary shocks over time, these models introduce adjustment costs by which agents find it optimal to change their decisions slowly. This paper presents another explanation that does not rely on any sort of adjustment costs or stickiness. In our economy, agents own assets and make occupational choices. Banks intermediate between agents demanding and supplying assets. Our interpretation is based on the way banks create credit and how the monetary authority affects the process of financial intermediation through its monetary policy. As the central bank lowers the interest rate by buying government bonds in exchange for reserves, high productive entrepreneurs are able to borrow more resources from low-productivity agents. We show that this movement of capital among agents sets in motion a response of the economy that resembles an expansionary phase of the cycle.

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