

In this paper we develop a monetary general equilibrium model where inflation, interest rates, firm value and credit spread are endogenously determined. This link allows us to relate inflation and credit spread in close form to the underlying real and monetary variables in an endogenous manner. We find that monetary shocks induce negative relationship between credit spread and inflation, expected or unexpected, while real production shocks induce a positive relation between them. The net effect depends on whether monetary or real shocks are more dominant, and whether they move in the same direction, which is related to the stance of monetary policy. Vector autoregression evidence on the dynamic responses of inflation and credit spread and the experience of the thirties versus postwar period confirm these findings.