

# U. Jerman & V. Quadrini

## Macroeconomics Effects of Financial Shocks

Discussion by Pietro Reichlin - LUISS

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this paper tries to fill this gap

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- ▶ a lot of investment is financed through retained earnings

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- ▶ collateral and credit ratings play important role
- ▶ firms may go bankrupt and bankruptcy is costly
- ▶ there is an external finance premium (typically counter-cyclical)



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But this is not J&Q paper..

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⇒ Firms are subject to an enforcement constraint

debt repayment is self-enforcing if **current output not too high, value of firm not too low, dividends not too high**

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Adverse financial shock  $\Rightarrow$  employment and dividends down

Adverse output shock  $\Rightarrow$  default less attractive  $\Rightarrow$  enforc.  
constraint relaxed  $\Rightarrow$  mild impact on employment

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Financial frictions introduce an important source of volatility into the model

Only way to understand big swings in output and labor along the cycle is by introducing financial frictions

# Problem

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But internal funds seem to play no role in J&Q's paper

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2. Dividends, investment, labor costs, interest payments are paid before revenue is realized
3. Agents can default on  $m$  only at interim stage
4.  $m$  exactly equals revenue  $F(k, l)$

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$$\underbrace{m + b'}_{\text{Tot Borr.}} = \underbrace{k' + d + Rb}_{\text{Tot. exp.}}$$
$$m \leq F(k)$$

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# Self-enforcement

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$$\Rightarrow F(k) \leq \xi V'/R \quad (\text{self-enf. constr.})$$



# Questions

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- ▶ Can we make no default self-enforcing by imposing a low enough Intratemporal Loan? This would be equivalent to imposing  $m < F(k)$ , i.e., the firm retains some internal funds
- ▶ Why default on Intratemporal loans only? What happens when you allow for default on intertemporal loans?
- ▶ Is it true that all firms are debt constrained? Financial shocks have a very asymmetric effects on (small and big) firms

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$$\xi = \frac{\text{output}}{\text{Value of firm} - \text{dividends}}$$

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Then,

$$\text{Value of firm} \uparrow \Rightarrow \xi \downarrow$$