Collateral Constraints as an Amplification Mechanism

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Abstract

Do large fluctuations arise from small shocks through financial frictions? In previous literature it is shown that a collateral constraint on interperiod debt for consumption smoothing does not have a quantitatively significant effect on the response of output to unexpected shocks. We focus on the collateral constraint on intraperiod debt for wage payments and examine the amplification of output. We find that output is significantly amplified in a standard functional form and parameter region. We also find that the region of the parameters for which the output is amplified is wider than that of previous literature.

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