Financial crises, Financial Shocks, and Unemployment

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Abstract

Historically, financial crises have huge impact on real economy e.g. real GDP or unemployment rate. In the paper, we focus on the relationship between financial crises and unemployment rate empirically and theoretically. In empirical part, we use country-level data to check whether the large increase in unemployment after the fiancial crises is general or not. We derive the result that after the period when financial crises occur, the unemployment rate is higher than recessions without financial crises and persistent. To obatain the result theoretically, we construct the DSGE model with working capital constraint and search friction in labor market. In the case of the recession without financial crises, the decline of marginal product of labor is the driving force of the increase of unemployment. By contrast, the shortage of the money the firms can borrow mainly affect unemployment rate after banking crises. This mechanism is supported by an empirical analysis. We show that after the financial crisis unemployment rate is lager and persistent. Finally, we endogenize the job separation rate because it is important factor that creates unemployment rate during recessions.

Keywords: financial crises, financial shocks, working captital constraint, unemployment, search-matching, endogenous job separation

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