ASSET PRICING AND THE PROPAGATION OF MACROECONOMIC SHOCKS

Ivan Jaccard
European Central Bank, DG-Research

Abstract
This paper considers the implications of habit formation and financial frictions for the propagation of macroeconomic shocks. In a model that is capable of matching asset pricing moments, a short-lived shock that destroys a small fraction of the economy's stock of pledgeable collateral generates a persistent recession, a stock market crash, and a flight-to-safety effect. This novel mechanism creates a tight link between the asset pricing implications of macroeconomic models and their ability to propagate and amplify the effects of macroeconomic shocks. (JEL: E32, E44, G10)

The editor in charge of this paper was Dirk Krueger.

Acknowledgments: This article has benefited from comments and suggestions from Dirk Krueger, three anonymous referees, Fiorella De Fiore, Skander van den Heuvel, Harald Uhlig, Yves Schüler, Marcello Miccoli, Alexi Savov and Jesse Wursten. Any remaining errors are my own responsibility. The views expressed in this article are my own and do not represent the views of the European Central Bank (ECB) or the Eurosystem.

E-mail: ivan.jaccard@ecb.europa.eu

Journal of the European Economic Association
Preprint prepared on 20 March 2017 using jeea.cls *v1.0.*