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Figure 11: Decomposition of Taxes on Debt: Gradual Optimism
Figure 12: Dynamics in Asymmetric Priors Calibration; Figure 13: Taxes on Debt: Asymmetric Priors

Sommario/riassunto

The interaction between credit frictions, financial innovation, and a switch from optimistic to pessimistic beliefs played a central role in the 2008 financial crisis. This paper develops a quantitative general equilibrium framework in which this interaction drives the financial amplification mechanism to study the effects of macro-prudential policy. Financial innovation enhances the ability of agents to collateralize assets into debt, but the riskiness of this new regime can only be learned over time. Beliefs about transition probabilities across states with high and low ability to borrow cha