

Presentation

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Introduction

- "Time-varying idiosyncratic risk and aggregate consumption dynamics"
 - Alisdair McKay
- "What drives heterogeneity in the marginal propensity to consume? Temporary shocks vs persistent characteristics"
 - Michael Gelman

Main Results

- The model has several sources of time-variation in idiosyncratic risks
- The paper introduces a rich income process that incorporates cyclical variation in the risks to long-term earning prospects
- Time-varying idiosyncratic risks substantially raises the volatility of aggregate consumption growth

sources of time-variation in idiosyncratic risks

- job-finding and separation rates vary
- the chances of experiencing a long-term earnings loss or long-term earnings gain vary
- average size of long-term earnings losses and gains vary over time with a risk factor x_t

Model

- individual

$$\mathbb{E}_0 \sum_{t=0}^{\infty} \beta^t (1 - \omega)^t \frac{C_t^{1-\gamma}}{1 - \gamma}$$

- individual's decision problem

$$V(A, \theta, m, S) =$$

$$\max_{K' \geq 0} \left\{ \frac{(A - K')^{1-\gamma}}{1 - \gamma} + \beta(1 - \omega) \mathbb{E} [V(A', \theta', m', S')] \right\}$$

$$\text{s.t. } A' = R(S') K' + (1 - \tau(S')) W(S') e^{(1-b^y)(\theta + \eta' + \xi')} n(m')$$

$$S \equiv \{z, \lambda, \zeta, x, \Gamma\}$$

- law of motion for the aggregate state

$$z' = \rho_z z + \epsilon'_z$$

$$\hat{\lambda}^{s'} = (1 - \rho_\lambda) \hat{\lambda}^{s*} + \rho_\lambda \hat{\lambda}^s + \epsilon'_\lambda$$

$$\hat{\zeta}' = (1 - \rho_\zeta) \hat{\zeta}^* + \rho_\zeta \hat{\zeta} + \epsilon'_\zeta$$

$$x' = \rho_x x + \epsilon'_x$$

- law of motion for the distribution of idiosyncratic states

$$\Gamma' = H_\Gamma(S, \zeta', \lambda')$$