Part d: Calculate the standard deviation of simulated c. Explain what you would qualitatively expect would occur to the standard deviation of c in the following cases:

(a) The borrowing constraint were zero.

(b) The relative risk aversion parameter doubled.

(c) The natural rate of interest doubled.

(d) Income volatility doubled.

Answers:

(a) No borrowing: harder to smooth, higher std than if borrowing were allowed.

(b) Higher risk aversion: stronger desire to smooth, lower std.

(c) Higher interest rate: saving pays more, easier to buffer, lower std.

(d) Higher income volatility: shocks are bigger, even with smoothing, higher std.