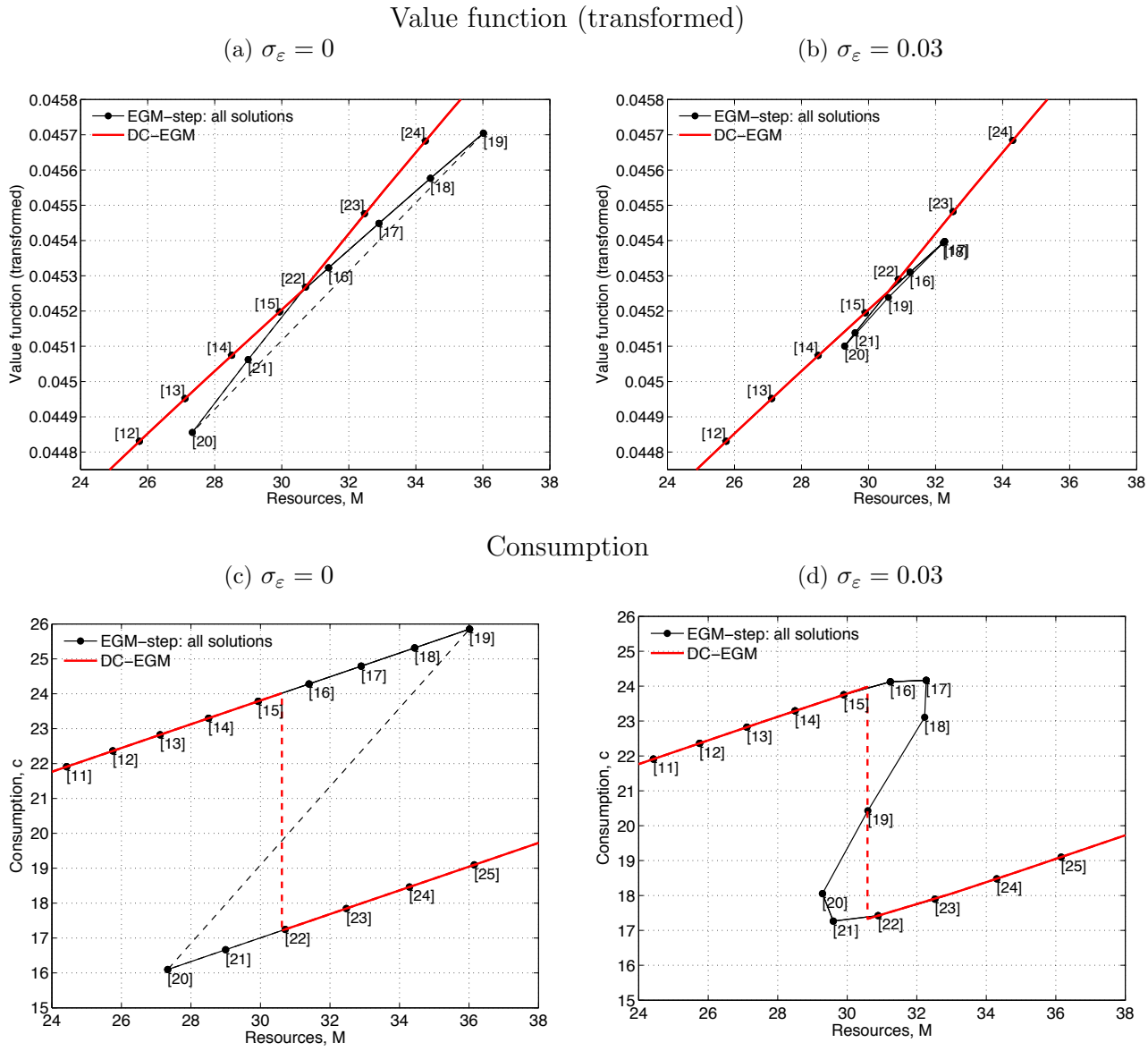
Figure 4: Non-concave regions and the elimination of the secondary kinks in DC-EGM.



Notes: The plots illustrate the output from the EGM-step of the DC-EGM algorithm (Algorithm 1) in a non-concave region. The dots are indexed with the index j of the ascending grid over the end-of-period wealth $\vec{A} = \{A^1, \ldots, A^G\}$ where $A^j > A^{j-1}$, $\forall j \in \{2, \ldots, G\}$. The connecting lines show the d_t-specific value functions $v_t(\vec{M}_t|d_t)$ and the consumption function $c_t(\vec{M}_t|d_t)$ linearly interpolated on the endogenous grid $\vec{M}_t$. computed on this grid are the outputs. The left panels illustrate the deterministic case without taste shocks, while in the right panels $\sigma_\varepsilon = 0.03$. The "true" solution, after applying the DC-EGM algorithm is illustrated with a solid red line. Dashed lines illustrate discontinuities. The solution is based on $G = 70$ grid points in $\vec{A}$, $R = 1$, $\beta = 0.98$, $y = 20$, $\sigma_\eta = 0$.