Uncertainty and Production: Sectoral Decomposition *

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Abstract

Not all sectors reduce production following higher uncertainty. I find that producers of inventory goods increase their production at times of elevated uncertainty. The uncertainty could be measures as macro or financial uncertainty, with robust findings. In all, certain sectors of the economy may benefit from greater turmoil.

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1 Outline

The papers of McDonald and Siegel (1986), Dixit, Dixit, and Pindyck (1994), and recently Bloom (2009) use a real option channel to show that uncertainty suppresses investment. The study of Fernández-Villaverde, Guerrón-Quintana, Rubio-Ramirez, and Uribe (2011) examines uncertainty in the context of an open economy, showing that volatility lowers domestic investment. Other papers suggest that uncertainty increases firms' cost of capital, or credit spreads, making investment more costly (see, e.g., Christiano, Motto, and Rostagno, 2010; Gilchrist, Sim, and Zakrajšek, 2014; Arellano, Bai, and Kehoe, 2019). Di Tella and Hall (2020) rely on a model that features insuperable idiosyncratic risk and predetermined labor. By contrast, the study of Segal (2019) shows that greater volatility of the investment sector leads to more investment.

In this study I build on the former insights, showing that all are mutual reconciled. Uncertainty can have different effect, depending on the sector. find that producers of inventory goods increase their production at times of elevated uncertainty. The uncertainty could be measures as macro or financial uncertainty, with robust findings. In all, certain sectors of the economy may benefit from greater turmoil.

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