ECO 6353 - Coding Assignment 2

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1 Identification of the Bugs

- The value of γ, which is 3.5 was not specified among the model parameters.

    - To solve this, we have add $\gamma = 3.5$ to the parameters.

- Inclusion of "small positive " in the equation for c2.
    To solve this, we have to remove "small positive" from the equation.

- Inclusion of x,y,z in the main loop.
    To solve this, we have to replace x,y,z with w_{orig}, a and $w1$ respectively.

2 Explanations

2.1 Setting the borrowing constraint to zero.

When the borrowing constraint is set to zero, it restricts the household to consume from only current period income and assets. This will affect consumption smoothing because households cannot borrow to smoothing their consumption when their hit by financial hardships. As a matter of fact, this could also trigger precautionary savings in order to smoothing future consumption.

2.2 Doubling the parameter for relative risk aversion.

When the parameter for relative risk aversion is doubled, the household would become more risk averse which means that they would like to hold more safer assets as insurance for future uncertainties. This could also lead to more precautionary savings and decrease in current level of consumption.