Incompleteness Shocks
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Discussed by Urban Jermann
Contribution

- Novel shock to the level of financial incompleteness, IS

Studied in two-agent model with endogenous capital allocation

Analytical results

IS leads to inefficient capital allocation and lower output

IS matters even if it is hedgeable or fully anticipated

Capital reallocation can be significant, output effects are more muted
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Capital is productive input and durable store of value
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Incompleteness shock

- Rewrite foc for capital

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- "Risky wedge" with one-period bond

\[ Z_t^E F' \left( K_t^E \right) - Z_t^H F' \left( K_t^H \right) = \text{cov}_t \left( m_{t+1}^H - m_{t+1}^E, Q_{t+1} \right) \]
Risky wedge example

With $Z^H = Z_0^E = Z_1^E = 1$ and $1 = Z_{2D}^E < Z_{2U}^E = 1.66$
Other points

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- Empirical evidence on "Risky wedge" incompleteness shock?
Derivatives volume growth (billion contracts)
Conclusion

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- Is this quantitatively important?