Financial Innovations and Macroeconomic Volatility

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The volatility of US business cycles has declined during the last two decades. During the same period the financial structure of firms has become more volatile. In this paper we develop a model in which financial factors play a key role in generating economic fluctuations. Innovations in financial markets allow for greater financial flexibility and generate a lower volatility of output together with a higher volatility in the financial structure of firms.

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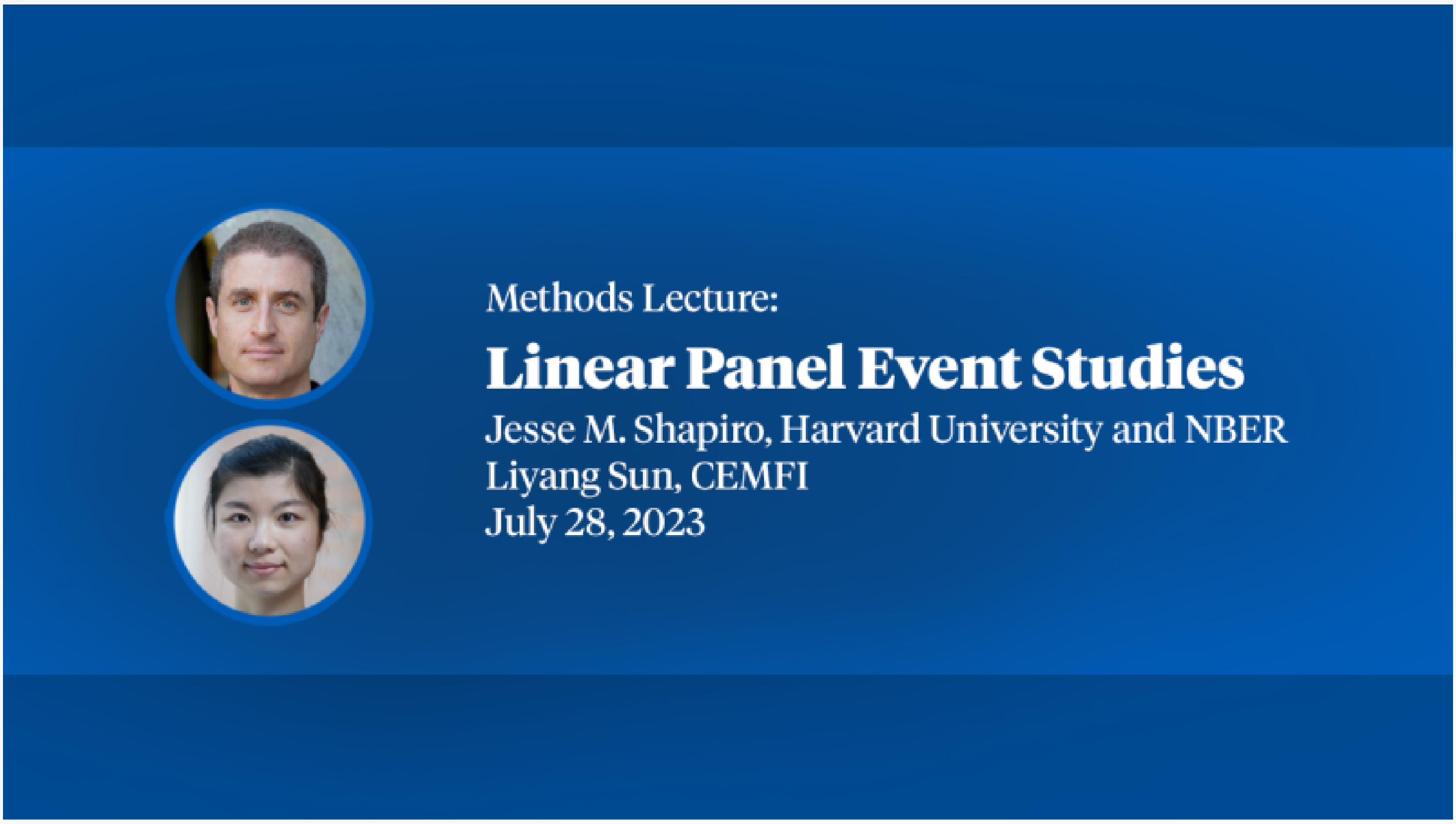

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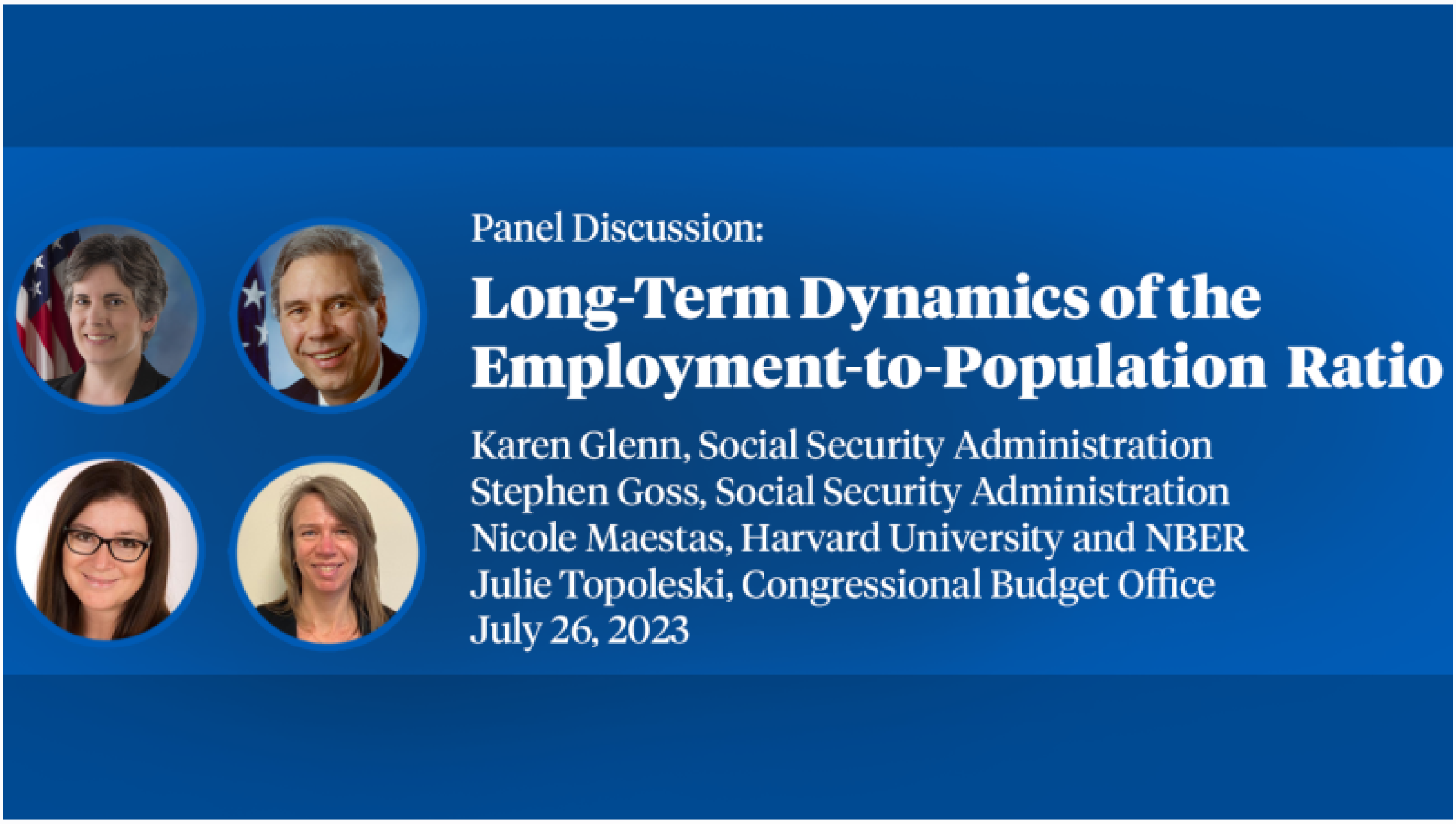

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