Economic Boom and Bust Originating from Expectation Errors in the Credit Market

Meiji University Tamegawa, Kenichi
Meiji University Fukuda, Shin

We clarify how expectation errors in the credit market bring about economic fluctuations. To achieve this, we employ simulation analysis based on a dynamic stochastic general equilibrium model that explicitly incorporates the banking sector. Moreover, since unemployment can exist in our model by assuming a matching friction. Therefore, we can investigate the effects of expectation errors on unemployment. The conclusions are outlined as follows: If firms fallaciously expect a rise in future asset prices, such optimistic expectations will cause the economy to overheat, resulting in an economic recession through a credit crunch.

Keywords: Expectation errors; News shock; Business cycle; Bank capital