

Essays on Expectations-Driven Business Cycles

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Abstract

This thesis addresses the role of imperfect competition in business cycles driven by expectations and beliefs about the future state of the economy. It consists of three self-contained papers.

The first paper examines the roles of composition of aggregate demand and taste for variety in a real business cycle model with endogenous entries and exits of monopolistically competitive firms. It finds that taste for variety can alone make the economy susceptible to endogenous (sunspot driven) business cycles. Importantly, in light of recent research suggesting that aggregate markups in the U.S. are procyclical, sunspot equilibria emerge with procyclical markups that are within empirically plausible ranges.

The second paper considers aggregate markup variations in business cycles driven by news about future total factor productivity. It shows that the addition of endogenous countercyclical markups and investment adjustment costs allows the standard one-sector real business cycle model to generate empirically supported expectations-driven fluctuations. The simulated model reproduces the regular features of U.S. aggregate fluctuations.

The third paper investigates the role of product variety effects and variable markups in expectations-driven business cycles. It demonstrates that taste for variety and investment adjustment costs allow the otherwise canonical real business cycle model to display quantitatively realistic fluctuations in response to news about future total factor productivity. Moreover, the interaction between price-cost decisions and firm entry and exit allows such business cycles to occur for empirically plausible levels of procyclical markups and variety effects.

Declaration

I, Oscar Pavlov, certify that this work contains no material which has been accepted for the award of any other degree or diploma in any university or other tertiary institution and, to the best of my knowledge and belief, contains no material previously published or written by another person, except where due reference has been made in the text. In addition, I certify that no part of this work will, in the future, be used in a submission for any other degree or diploma in any university or other tertiary institution without the prior approval of the University of Adelaide and where applicable, any partner institution responsible for the joint-award of this degree.

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