Rational Sentiments and Financial Frictions
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Comments by Enrico Mallucci

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The paper

- Documents and analyzes the existence of sentiment-driven sunspot equilibria in a canonical macro-model with imperfect risk sharing
- Show that rational sentiment can generate:
  - sudden financial crises characterized by volatility spikes
  - asset-price booms followed by busts and financial crises

Main Mechanism

- There are two types of agents: households and experts.
  - the return of capital is higher with experts $\Rightarrow$ aggregate output affected by capital ownership
- markets are incomplete $\Rightarrow$ No risk sharing.
- Prices of capital are subject to sunspot volatility (partial equilibrium?): they may fluctuate for no fundamental reason
- When there is fear of higher price volatility, experts sell to households, due to risk-sharing considerations (can you please elaborate?)
- Aggregate productivity and the price of capital fall, and volatility increases, validating the initial fear.

Comments

1. During crises, experts sell assets to naive investors. Is that realistic?
   - During COVID-19 retail investors were on the buying side
   - In 2008, very sophisticated investors were on the buying side

2. Rational sentiment allows to write models of financial crises, abstracting from borrowing constraints and illiquidity. Do we really want that?
   - In 2020, the market sell off was largely due to search for liquidity
   - In 2008, uncertainty around the value of collateral played a key role

3. How really exogenous are shocks to the (perceived) volatility of prices?
   - De Ferra and Mallucci (2021)