GUIDO LORENZONI

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DATE OF BIRTH: 01/22/71 **SEX**: M **CITIZENSHIP**: Italy

UNDERGRADUATE STUDIES:

'Laurea' (BA) in Economics and Commerce, University of Rome – "La Sapienza", 1994

GRADUATE STUDIES:

MA in Economics, University Pompeu Fabra, Barcelona, 1997

MIT:

DATES: September 1997- present

THESIS TITLE: 'Essays on Liquidity Provision in Macroeconomics'

EXPECTED COMPLETION DATE: May 2001

THESIS COMMITTEE AND REFERENCES:

Professor Ricardo Caballero
MIT Department of Economics, E52-252A
50 Memorial Drive
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Professor Abhijit Banerjee
MIT Department of Economics, E52-
50 Memorial Drive
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Professor Daron Acemoglu
MIT Department of Economics, E52-371
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DESIRED TEACHING AND RESEARCH:

Primary Fields: Macroeconomics, Monetary Economics

Secondary Fields: Microeconomic Theory, Banking and Financial Markets

TEACHING EXPERIENCE:

Fall 2000	Advanced Macroeconomics (grad.), Teaching Assistant to Professors N. Kiyotaki and R. Caballero.
2000-2001	Macroeconomic Theory (grad.), Teaching Assistant to Professors R. Caballero and O. Blanchard.
Spring 2000	Game Theory (grad.), Teaching Assistant to Professor Maskin.
1995-1996	Teaching Assistant to various undergraduate classes in micro and macro at the University Pompeu Fabra, Barcelona.

RELEVANT POSITIONS HELD:

1999	Research Assistant to Professor Ricardo Caballero, MIT.
1996-1997	Research Assistant to Professor Albert Marcet, University Pompeu Fabra.

HONORS, SCHOLARSHIPS, AND FELLOWSHIPS:

1999-2000	David Finch Scholarship (MIT)
1997-1999	John Castle International Fellowship (MIT)
1995	University of Turin (Italy) Graduate Scholarship
1995	Prize "Fausto Vicarelli" (U. of Rome) for Undergraduate Thesis

RESEARCH IN PROGRESS:

"Interest Rate Stabilization and the Allocation of Liquidity" (*Job market paper)*

This paper studies liquidity provision in an economy with decentralized intermediation and studies the potential role of monetary policy in improving its efficiency. Consumers and firms obtain liquid funds from banks, while banks obtain funds from other banks in the money market. Financial markets are incomplete because bank-specific liquidity shocks are unobservable and because banks cannot monitor each other's balance sheets. With incomplete financial markets the competitive equilibrium is constrained inefficient. The direction of the inefficiency is that banks extend too large credit lines and tend to be illiquid on the money market. This generates excess interest rate volatility and provides a rationale for interest rate stabilization. Introducing a nominal friction (deposits denominated in dollars), a central bank can intervene to stabilize the interest rate. In the spirit of Poole's analysis I show that when the source of the shocks is purely technological, interest rate stabilization is less desirable than when the source of the shocks is mainly liquidity driven. Also, the desirability of interest rate stabilization is greater when bank-specific shocks are large and when the banking system is more decentralized. In the last part of the paper I endogenize the structure of the banking system and show that it is not necessarily the case that a more centralized banking system is superior to a decentralized one. This happens because banks with access to internal sources of liquidity may have a destabilizing effect on the money market.

"Household Wealth and Consumption Variability"

This paper studies the empirical relevance of precautionary savings looking at the relationship between household financial wealth and the variability of consumption. Models of precautionary savings predict that when accumulated wealth is large enough it will be used to reduce the variability of consumption against income and non-income shocks. When the Euler equation holds, this variability coincides with the second moment of the Euler equation residual . Using PSID data, the paper offers both parametric and non-parametric evidence of a monotone decreasing relation between the level of household wealth and the variability of marginal utility in the immediate future, which can be taken as indirect evidence in favor of the precautionary motive. The results extend those of Zeldes (1989) on liquidity constraints. Zeldes concentrates on the conditional first moment of the Euler equation residual; here I study the conditional *second* moment of the Euler equation residual, which is expected to be smoothly decreasing over a range of wealth levels. These results can also be interpreted as a test of the full insurance model against the specific alternative hypothesis of self-insurance. A by-product of this analysis is the study of an identification problem that arises with the log-linearized version of the Euler equation. If the residuals are conditionally heteroskedastic with respect to the instruments, the traditional linearized model is incorrectly identified. In this context heteroskedasticity affects not only the efficiency but also the consistency of the estimates. The paper implements a semi-linear strategy, which, under certain assumptions, regains consistency while preserving the simplicity of linear panel data models.

“Supply of Funds, Maturity and Spreads on Emerging Markets Bonds”, with Fernando Broner

This paper studies the behavior of spreads on emerging market sovereign bonds of different maturity. First, we study default risk under a simple form of the expectation hypothesis. We show that the observed spreads on long term bonds are too volatile with respect to the hazard of default implicit in the short term rates (this amounts to a violation of the expectation hypothesis). We propose an explanation based on risk averse international investors (specialists) with limited wealth and subject to financial constraints. During financial turmoil, holders of long term bonds of emerging economies are subject to considerable price risk. We use a simple model to show that this implies that observed risk premia will be correlated with the current price. Finally, we present empirical evidence consistent with this interpretation. After large drops in bonds’ prices the risk premium on emerging markets bonds rises sharply. The rise in the risk premium reflects an increase in the effective risk aversion of the typical bond holder because increases in excess returns are not accompanied by sizeable increases the volatility of returns. That is, Sharpe ratios increase after large price drops. The paper also argues that this can explain why emerging economies may be reluctant to lengthen the maturity of their debt if they face a pool of international investors with limited wealth and liquidity concerns.

OTHER WORK:

“The Parametrized Expectations Approach: Some Practical Issues”, with Albert Marcet
in *Computational Methods for the Study of Dynamic Economies*, R. Marimon and A. Scott (eds.), Oxford University Press, 1999

We discuss some practical issues related to the use of the Parameterized Expectations Approach (PEA) for solving non-linear stochastic dynamic models with rational expectations. This approach has been applied in models of macroeconomics, financial economics, economic growth, contract theory, etc. It turns out to be a convenient algorithm, especially when there is a large number of state variables and stochastic shocks inside the conditional expectations. We discuss some practical issues having to do with the application of the algorithm, and we discuss a Fortran program for implementing the algorithm that is available on the internet. We discuss these issues in a battery of six examples.

“Wage Differentials and Firm Heterogeneity in Italy”, ICER Working Paper, 1996 (*in italian)*

This paper studies the evolution of wage differentials in Italy and tries to disentangle the sources of increasing differentials by means of a simple variance decomposition exercise. The main sources of the increase in wage variability appear to be an increase in the wage gap between white and blue-collar workers and a sizeable increase in the firm size effect. Also the variance in wages across small firms appears large and increasing in contrast to the smaller and stable variance across large firms. This provides indirect evidence in favor of a dualistic characterization of the Italian labor market, with rigidities concentrated in the large firm sector and a highly flexible small firm sector.