

Animal Spirits, Financial Markets and Aggregate Instability
Wei Dai, Mark Weder and Bo Zhang

This paper examines whether people's animal spirits were drivers of U.S. business cycle fluctuations. In the context of an estimated macroeconomy with financial market frictions, animal spirits shocks account for well over one third of output fluctuations. Exogenous financial frictions and technology shocks are considerably less important. U.S. data strongly favours the indeterminacy model over versions of the economy in which animal spirits cannot play a role. A substantial part of aggregate output's contraction during the Great Recession was caused by adverse shocks to expectations.