

TURBULENT BUSINESS CYCLES

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Abstract

Abstract. Firm-level evidence suggests that turbulence that reshuffles firms' productivity rankings rises sharply in recessions. An increase in turbulence reallocates labor and capital from high- to low-productivity firms, reducing aggregate TFP and the stock market value of firms. A real business cycle model with heterogeneous firms and financial frictions can generate the observed macroeconomic and reallocation effects of turbulence. In the model, increased turbulence makes high-productivity firms less likely to remain productive, reducing their expected equity values and tightening their borrowing constraints relative to low-productivity firms. This leads to a reallocation that reduces aggregate TFP. Unlike uncertainty, turbulence changes both the conditional mean and the conditional variance of the firm productivity distribution, enabling a turbulence shock to generate a recession with synchronized declines in aggregate activities.