

Job Uncertainty and Deep Recessions

Abstract

We study a heterogeneous agents model which combines matching frictions in the labor market with incomplete asset markets and nominal rigidities. Workers can experience job terminations that send them into short term unemployment or more serious job terminations that require a more difficult search process, a state we call for mis-match. We show an increase in job uncertainty decreases aggregate demand which lowers hiring and therefore produces even more job uncertainty and potentially a deep recession. The amplification mechanism is small when asset markets are complete, prices are flexible or unemployment is predominantly short term. Quantitatively, with a moderate and empirically plausible amount of mis-match, the model can account for the amplitude of the increase in unemployment during the Great Recession, for the increase in unemployment duration, and for much of the shift and movement along the Beveridge curve.