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PII: S0022-0531(18)30033-4
DOI: https://doi.org/10.1016/j.jet.2018.01.020
Reference: YJETH 4745

To appear in: *Journal of Economic Theory*

Received date: 28 June 2017
Revised date: 8 January 2018
Accepted date: 30 January 2018

Please cite this article in press as: Bethune, Z., et al. Indeterminacy in credit economies. *J. Econ. Theory* (2018), https://doi.org/10.1016/j.jet.2018.01.020

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Indeterminacy in Credit Economies*

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First version: June 2014; This version: January 2018

Abstract

We characterize the equilibrium set of a two-good, pure-credit economy with limited commitment, under both pairwise and centralized meetings. We show that the set of equilibria derived under "not-too-tight" solvency constraints (Alvarez and Jermann, 2000) commonly used in the literature is of measure zero in the whole set of Perfect Bayesian Equilibria. There exist a continuum of stationary equilibria, a continuum of endogenous credit cycles of any periodicity, and a continuum of sunspot equilibria, irrespective of the assumed trading mechanism. Equilibria featuring "too-tight" solvency constraints can generate growing credit limits over time, periodic credit shutdowns, and heterogeneous debt limits across ex-ante identical borrowers. Moreover, we provide examples of credit cycles that dominate, from a social welfare point of view, all equilibria with "not-too-tight" solvency constraints.

JEL Classification: D83, E32, E51
Keywords: Credit cycles, limited commitment, money.

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