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The impact of idiosyncratic uncertainty when investment opportunities are endogenous

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1 The Impact of Idiosyncratic Uncertainty
2 When Investment Opportunities Are Endogenous

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5 **Abstract**

6 This paper develops a general equilibrium model to study the im-
7 pact of aggregate fluctuations in idiosyncratic volatility that incorpo-
8 rates the endogenous determination of investment opportunities. By
9 making investment options more valuable, an increase in volatility en-
10 courages the creation of new investment options. I find the response of
11 the economy to a volatility shock depends on how investment opportu-
12 nities are obtained. If potential entrants are allowed to invest in new
13 idiosyncratic technologies, thereby acquiring options for further invest-
14 ment, the volatility shock increases overall investment and results in an
15 economic boom. On the other hand, if such an investment in option cre-
16 ation is precluded and investment opportunities are exogenously given,
17 the volatility shock decreases aggregate investment.

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