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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

3                   Junghoon Lee\*

4                   February 18, 2016

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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