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Pierre-Daniel Sarte, Felipe Schwartzman, Thomas A. Lubik

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What Inventory Behavior Tells Us About How Business Cycles Have Changed

Pierre-Daniel Sarte Felipe Schwartzman*

Thomas A. Lubik†

Federal Reserve Bank of Richmond

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Abstract

Beginning in the mid-1980s, U.S. business cycles changed in important ways, notably via distinctive shifts in the comovement and relative volatilities of labor productivity, hours, output, and inventories. Inventories provide additional information relative to aggregate investment regarding firms' intertemporal decisions, and thus additional insight in explaining business cycles. We show that variations in the discount factor estimated using inventories, which may be interpreted as fluctuations in a generalized investment wedge, play a key role in explaining the shifts in U.S. business cycles observed after the mid-1980s. Moreover, these variations correlate well with independent measures of credit market frictions.

Keywords: Business Cycles, Inventories, Investment Wedge, Financial Frictions

JEL Code: E32, E44

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*Corresponding Author. Tel: +1-804-697-4438. Email: felipe.schwartzman@rich.frb.org. Mailing address: Federal Reserve Bank of Richmond, Research Department, P.O. Box 27622, Richmond, VA 23261.

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