

Financial Stability in the I Theory

$$\Delta \text{price} = f(\Delta E[\text{future cash flows}], \Delta \text{risk premia})$$

■ Endogenous risk (dynamics)

- Amplification
- Runs

■ Risk premia (time varying)

- Term spread: expectations hypothesis fails
- Credit spread: default risk + risk premium

predicts future economic activity

Gilchrist & Zakrajsek

*Risk premium news
the main driver*