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

Depends on "undercapitalization" of critical sectors

Risk premium news the main driver