Traditional models of the business cycle rely on the assumption that the economy is populated by agents who have similar characteristics such as taste, income, or productivity. Despite offering simple and elegant macroeconomic models, this assumption masks the rich interplay between cross-sectional and aggregate cyclical movements. The goal of this dissertation is to show in two distinct contexts of heterogeneity—households and firms—how such interplay can shed new light on classic puzzles in the macro-finance literature such as the high volatility of unemployment or the large equity premium.

The first chapter, titled “The Macroeconomics of Consumer Finance”, studies the macroeconomic effects of consumer credit conditions in an incomplete-market, general equilibrium model where households hold unsecured debt, and firms use labor. I show that consumer finance disturbances can cause business cycle fluctuations through a rich interplay between credit and labor risks. As unemployment rises, households are more likely to default, translating into tighter credit conditions that reduce their consumption and cause further unemployment. Such feedback loop is reinforced by precautionary-saving motives among unconstrained households. Surprisingly, this mechanism can explain a large fraction of the volatility and persistence of U.S. unemployment even though it abstracts from traditional frictions like search or price stickiness.

In the second chapter, titled “Misallocation Cycles” and co-authored with Lars-Alexander Kuehn and David Schreindorfer, we estimate a general equilibrium model with firm heterogeneity and a representative household with Epstein-Zin preferences. Firms face investment frictions and permanent shocks, which feature time-variation in common idiosyncratic skewness. Quantitatively, the model replicates well the cyclical dynamics of the cross-sectional output growth and investment rate distributions. Economically, the model is able to generate business cycles through inefficiencies in the allocation of capital across firms. These cycles arise because (i) permanent Gaussian shocks give rise to a power law distribution in firm size and (ii) rare negative Poisson shocks cause time-variation in common idiosyncratic skewness.