

Crises and Prices

Information Aggregation, Multiplicity and Volatility*

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First draft: January 2004
This version: October 2005

Abstract

Crises are volatile times when endogenous sources of information are closely monitored. We study the role of information in crises by introducing a financial market in a coordination game with imperfect information. The asset price acts as a public signal aggregating dispersed private information. In contrast to the case with exogenous information, we find that uniqueness may not be obtained as a perturbation from common knowledge: multiplicity is ensured with small noise. We further show that multiplicity may emerge in the financial price itself. Moreover, less noise may contribute toward volatility even when the equilibrium is unique. Finally, similar results obtain for a model without a financial market, where individuals instead observe one another's actions, highlighting the importance of endogenous information more generally.

JEL Codes: D8, E5, F3, G1.

Keywords: Multiple equilibria, coordination, global games, speculative attacks, currency crises, bank runs, financial crashes, rational expectations.

* We thank Daron Acemoglu, Fernando Alvarez, Manuel Amador, Olivier Blanchard, Gadi Barlevy, Ricardo Caballero, V.V. Chari, Harold Cole, Christian Hellwig, Patrick Kehoe, Stephen Morris, Alessandro Pavan, Bernard Salanié, José Scheinkman, Balázs Szentes, Aleh Tsyvinski, and seminar participants at Boston University, Brown, Columbia, Duke, Georgetown, Harvard, MIT, Princeton, Stanford, UC-Berkeley, UCLA, the Federal Reserve Banks of Boston, Chicago and Minneapolis, the 2004 Minnesota Summer Workshop in Macroeconomic Theory, the 2004 UTDT Summer Workshop in International Economics and Finance, the 2005 NBER Economic Fluctuations and Growth meeting in San Francisco, the 2005 Annual CARESS-Cowles Conference on General Equilibrium, the 2005 workshop on Beauty Contests in Cambridge, UK, the 2005 SED meeting, and the 2005 NBER Summer Institute. We are grateful to Emily Gallagher for valuable editorial assistance and to the Federal Reserve Bank of Minneapolis for their hospitality during the time the revision for this paper was completed.

1 Introduction

It's a love-hate relationship, economists are at once fascinated and uncomfortable with multiple equilibria. On the one hand, economic and political crises can be described as times of high non-fundamental volatility: they involve large and abrupt changes in outcomes, but often lack obvious comparable changes in fundamentals. Many attribute an important role to more or less arbitrary shifts in 'market sentiments' or 'animal spirits', and models with multiple equilibria formalize these ideas.¹ On the other hand, these models can also be viewed as incomplete theories, which should ultimately be extended along some dimension to resolve the indeterminacy. [Morris and Shin \(1998, 2000\)](#) argue that this dimension is information, that multiplicity vanishes once the economy is perturbed away from the perfect-information benchmark.

This result is obtained with an exogenous information structure, but information is largely endogenous in most situations of interest. Financial prices and macroeconomic indicators convey information about what others are doing and thinking. These variables are monitored intensely during times of crises and appear to be an important part of the phenomena. As an example, consider the Argentine 2001–2002 crisis, which included devaluation of the peso, default on sovereign debt, and suspension of bank payments. Leading up to the crisis, the peso-forward rate and bank deposits deteriorated steadily throughout 2001. This was widely reported by news media and investor reports, and closely watched by people making important economic decisions.

The aim of this paper is to understand the role of endogenous information in crises. We focus on two distinct forms of non-fundamental volatility. First, we investigate the existence of multiple equilibria, since sunspots could then create volatility unrelated to fundamentals. Second, for situations with a unique equilibrium, we examine the sensitivity of outcomes to non-fundamental disturbances. We argue that endogenizing public information is crucial for understanding both sources of volatility.

The backbone of our model is the coordination game that Morris-Shin and others have used to capture applications such as currency crises, bank runs and financial crashes. We introduce a financial market where individuals trade using their private information. The rational-expectations equilibrium price aggregates disperse private information, while avoiding perfect revelation due to unobservable supply shocks as in [Grossman and Stiglitz \(1976\)](#). This price is our endogenous public signal.

The main insight to emerge is that the precision of *endogenous* public information increases

¹ Applications range from bank runs, currency attacks, debt crises, and financial crashes, to riots, revolutions, and social change. See, for example, [Diamond and Dybvig \(1983\)](#), [Obstfeld \(1986, 1996\)](#), [Calvo \(1988\)](#), [Cooper and John \(1988\)](#), [Cole and Kehoe \(1996\)](#), [Velasco \(1996\)](#). [Cooper \(1998\)](#) provides an excellent review.

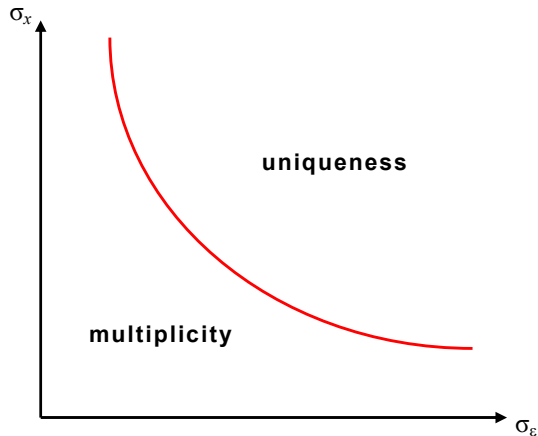


Figure 1: σ_x measures the exogenous noise in private information and σ_ε the exogenous noise in the aggregation of information.

with the precision of *exogenous* private information. When private signals are more precise, individuals' asset demands are more sensitive to their information. As a result, the equilibrium price reacts relatively more to fundamental than to non-fundamental variables, conveying more precise public information.

This has important implications for the determinacy of equilibria. The endogenous increase in the precision of public information permits agents to better forecast one another's actions and thereby makes it easier to coordinate. Consequently, uniqueness need not obtain as a perturbation away from the perfect-information benchmark. Indeed, in our baseline model multiplicity is *ensured* when noise is small.

This result is illustrated in [Figure 1](#), which displays the regions of uniqueness and multiplicity in the exogenous parameter space of our model. On the vertical axis σ_x represents the noise in private information; on the horizontal axis σ_ε represents the noise in the aggregation process, namely, the randomness in asset supply. Multiplicity obtains when either σ_x or σ_ε is sufficiently small.

In our baseline model the asset's dividend depends merely on the exogenous fundamentals. The financial market then provides information relevant for the coordination game, but there is no feedback in the opposite direction. In an extension we allow for such a feedback by considering the possibility that the dividend depends on the outcome of the coordination game. This may capture, in a stylized fashion, the real rate of return on peso-forwards during currency attacks, or more generally stock-market returns during economic crises. Interestingly, multiplicity then emerges in the equilibrium price. This is easily explained. In equilibrium, the price affects the coordination outcome; the outcome in turn affects the dividend; hence, the dividend itself is a function of the price. Since a higher price can lead to a higher dividend, the

demand for the asset is backward bending, giving rise to multiple intersections with supply.

Motivated by bank runs and riots, we also consider a model where individuals do not trade a financial asset but instead directly watch over what others are doing: everyone observes a noisy signal of the average action in the population. This introduces endogenous public information in the Morris-Shin framework parsimoniously, without the need for modeling a financial market. It also brings a main element of herding models, the observation of other players' actions, into coordination games. Our results on equilibrium multiplicity carry over here, illustrating that our key mechanism is information aggregation—not the particular form that arises through financial markets.

Results on multiplicity are of interest because non-fundamental volatility may arise if agents use sunspots to coordinate on different equilibria. However, our results are not limited to an interpretation of crises as situations with multiple equilibria. We show that a reduction in noise can increase the sensitivity of outcomes to non-fundamental disturbances, thus contributing to volatility, even when the equilibrium is unique.

Related Literature. Our analysis builds on [Morris and Shin \(1998, 2000, 2003\)](#), underscoring their general theme that the information structure is crucial in coordination games. We also share with [Chari and Kehoe \(2003\)](#) the perspective that the distinctive feature of crises is non-fundamental volatility, although we focus on the interplay of information and coordination rather than herding.

[Atkeson \(2000\)](#), in his discussion of [Morris and Shin \(2000\)](#), was the first to highlight the potential role of financial markets as endogenous sources of public information. He noted that fully-revealing prices could restore common knowledge. By introducing noise in the aggregation process, we ensure that none of our results are driven by restoring common knowledge.

Closely related is [Hellwig, Mukherji and Tsyvinski \(2005\)](#), who endogenize interest rates in a currency-crises model. Their model also features information aggregation, but they focus on how the determinacy of equilibria depends on whether the central bank's decision to devalue is triggered by large reserve losses or high interest rates. [Tarashev \(2003\)](#) considers a similar application, but focuses on conditions that deliver a unique equilibrium.

The information structure is endogenous also in [Angeletos, Hellwig and Pavan \(2003, 2004\)](#), but in different ways. They examine, respectively, signaling effects in a policy game and the interplay between information and crises in a dynamic setting. [Dasgupta \(2003\)](#) introduces signals of others' actions in an investment game, as in [Section 5](#) of this paper, but assumes that these signals are entirely private instead of public.

Finally, our paper contributes to the rational expectations literature by introducing a coordinating role for prices. In this literature, prices only provide information regarding exogenous dividends. In contrast, in our framework prices are also useful for predicting one

another’s actions and hence affect coordination. This novel coordinating role is crucial for our results on price multiplicity and volatility.

The rest of the paper is organized as follows. [Section 2](#) introduces the basic model and reviews the exogenous information benchmark. [Section 3](#) incorporates an asset market and examines the determinacy of equilibria. [Section 4](#) examines multiplicity in the price. [Section 5](#) studies the model with direct signals on actions. [Section 6](#) considers comparative statics in regions with a unique equilibrium. [Section 7](#) concludes.

2 The Basic Model: Exogenous Information

Before introducing a financial price or other endogenous public signals, we briefly review the backbone of our model with exogenous information, as in [Morris and Shin \(2000, 2004\)](#).

Setup

Actions and Payoffs. There is a status quo and a measure-one continuum of agents, indexed by $i \in [0, 1]$. Each agent i can choose between two actions, either attack the status quo $a_i = 1$, or not attack $a_i = 0$. The payoff from not attacking is normalized to zero. The payoff from attacking is $1 - c$ if the status quo is abandoned and $-c$ otherwise, where $c \in (0, 1)$ parameterizes the cost of attacking. The status quo, in turn, is abandoned if and only if $A > \theta$, where A denotes the mass of agents attacking and θ is the exogenous fundamental representing the strength of the status quo. It follows that the payoff of agent i is

$$U(a_i, A, \theta) = a_i(\mathbf{1}_{A>\theta} - c),$$

where $\mathbf{1}_{A>\theta}$ is the indicator of regime change.

Our normalization that $U(0, A, \theta) = 0$ is irrelevant for equilibrium behavior, and hence for our positive results.² The key property of the payoff structure is a coordination motive: $U(1, A, \theta) - U(0, A, \theta)$ increases with A , so the incentive to attack increases with the mass of agents attacking. If θ were commonly observed by all agents, both $A = 1$ and $A = 0$ would be an equilibrium whenever $\theta \in (\underline{\theta}, \bar{\theta}] \equiv (0, 1]$. This interval represents the critical range of fundamentals over which the regime outcome depends on the size of the attack.

Interpretations. In models of self-fulfilling currency crises, as in [Obstfeld \(1986, 1996\)](#) and [Morris and Shin \(1998\)](#), the central bank is forced to abandon its peg when a sufficiently

² In contrast, welfare analyses would be sensitive to the specification of $U(0, A, \theta)$ —one must take a stand depending on the application. For example, one may wish to assume that $U(0, A, \theta)$ depends on A and θ to capture the idea that crises are undesirable.

large group of speculators attacks the currency; θ then parameterizes the amount of foreign reserves or the ability and willingness of the central bank to maintain its peg. In models of bank runs, such as [Goldstein and Pauzner \(2000\)](#) and [Rochet and Vives \(2004\)](#), regime change occurs when a large enough number of depositors decide to withdraw their deposits, forcing the banking system to suspend payments. Another possible interpretation is an economy with investment complementarities, as in [Cooper and John \(1988\)](#), [Chamley \(1999\)](#) and [Dasgupta \(2003\)](#).³

Information. Following Morris-Shin, information is assumed imperfect and asymmetric, so that θ is not common knowledge. In the beginning of the game, nature draws θ from a given distribution, which constitutes the agents' common prior about θ . For simplicity, the prior is taken to be the improper uniform over the entire real line. Agent i then receives a private signal $x_i = \theta + \sigma_x \xi_i$, with $\sigma_x > 0$ and $\xi_i \sim \mathcal{N}(0, 1)$ is independent of θ , and independently distributed across agents. Agents also observe an *exogenous* public signal $z = \theta + \sigma_z \varepsilon$, where $\sigma_z > 0$ and $\varepsilon \sim \mathcal{N}(0, 1)$ is common noise, independent of both θ and ξ .⁴ The information structure is parameterized by the standard deviations σ_x and σ_z ; equivalently, by $\alpha_x = \sigma_x^{-2}$ and $\alpha_z = \sigma_z^{-2}$, the precisions of private and public information.

Equilibrium Analysis

Throughout the paper, we focus on *monotone equilibria* defined as perfect Bayesian equilibria such that, for a given realization z of the public signal, an agent attacks if and only if the realization x of his private signal is less than some threshold $x^*(z)$.⁵

In such an equilibrium, the aggregate size of the attack is $A(\theta, z) = \Phi(\sqrt{\alpha_x}(x^*(z) - \theta))$, where Φ denotes the cumulative distribution function for the standard normal. The status quo is then abandoned if and only if $\theta \leq \theta^*(z)$, where $\theta^*(z)$ solves $A(\theta, z) = \theta$, or equivalently

$$x^*(z) = \theta^*(z) + \frac{1}{\sqrt{\alpha_x}} \Phi^{-1}(\theta^*(z)). \quad (1)$$

It follows that the expected payoff from attacking is $\Pr(\theta \leq \theta^*(z) \mid x, z) - c$ and therefore $x^*(z)$ must solve the indifference condition $\Pr(\theta \leq \theta^*(z) \mid x, z) = c$. Since posteriors about θ are normally distributed with mean $\frac{\alpha_x}{\alpha_x + \alpha_z} x + \frac{\alpha_z}{\alpha_x + \alpha_z} z$ and precision $\alpha = \alpha_x + \alpha_z$, this condition

³ Other applications include debt crises, financial crashes, and revolutions ([Cole and Kehoe, 1996](#); [Atkeson, 2000](#); [Morris and Shin, 2004](#); [Corsetti, Guimaraes and Roubini, 2004](#); [Edmond, 2005](#)).

⁴ Normality makes the analysis of the effects of public information tractable (see [Morris and Shin, 1999, 2000, 2003, 2004](#)).

⁵ Our main results concerning multiple equilibria are obtained even within this restricted class. Moreover, with exogenous information, uniqueness within this class implies overall uniqueness.

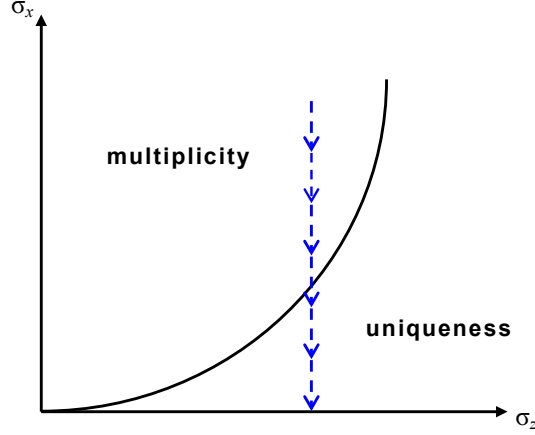


Figure 2: Exogenous information. σ_x and σ_z parameterize the noise in private and public information; uniqueness is ensured for σ_x small enough.

is

$$\Phi\left(\sqrt{\alpha_x + \alpha_z}\left(\theta^*(z) - \frac{\alpha_x}{\alpha_x + \alpha_z}x^*(z) - \frac{\alpha_z}{\alpha_x + \alpha_z}z\right)\right) = c. \quad (2)$$

Hence, an equilibrium is simply identified with a joint solution to (1) and (2).

Substituting (1) into (2) gives a single equation in θ^* :

$$-\frac{\alpha_z}{\sqrt{\alpha_x}}\theta^* + \Phi^{-1}(\theta^*) = \sqrt{1 + \frac{\alpha_z}{\alpha_x}}\Phi^{-1}(1 - c) - \frac{\alpha_z}{\sqrt{\alpha_x}}z. \quad (3)$$

It is easy to check that this equation always admits a solution and that the solution is unique for every z if and only if $\alpha_z/\sqrt{\alpha_x} \leq \sqrt{2\pi}$, which proves the following result.

Proposition 1 (Morris-Shin). *In the game with exogenous information, the equilibrium is unique if and only if $0 < \sigma_x \leq \sigma_z^2\sqrt{2\pi}$.*

Figure 2 depicts the regions of (σ_x, σ_z) for which the equilibrium is unique. For any positive σ_z , uniqueness is ensured by a sufficiently small positive σ_x . The key intuition behind this result is that private information anchors individual behavior and limits the ability to forecast one another's actions. The lower σ_x is relative to σ_z , the more heavily individuals use their private information. Since private information is diverse, this makes it more difficult for individuals to predict the actions of others—heightening strategic uncertainty. When this effect is strong enough, multiplicity breaks down.

Moreover, as $\sigma_x \rightarrow 0$ individuals cease to use the public signal so the equilibrium dependence on the common noise ε vanishes. Indeed, letting $R(\theta, \varepsilon) = \mathbf{1}_{A(\theta, \theta + \sigma_z \varepsilon) > \theta}$ denote the equilibrium regime outcome, the following limit result holds.

Proposition 2 (Morris-Shin Limit). *In the limit as $\sigma_x \rightarrow 0$, there is a unique equilibrium in which $R(\theta, \varepsilon) \rightarrow 1$ if $\theta < \hat{\theta}$ and $R(\theta, \varepsilon) \rightarrow 0$ if $\theta > \hat{\theta}$, where $\hat{\theta} = 1 - c$.*

Proof. See Appendix. ■

This limit illustrates a sharp discontinuity of the equilibrium set around $\sigma_x = 0$: a small perturbation away from perfect information suffices to obtain a unique equilibrium. It also implies that crises, defined as situations displaying high non-fundamental volatility, cannot be addressed in the limit as $\sigma_x \rightarrow 0$ since the unique equilibrium becomes insensitive to ε .

3 Financial Markets: Endogenous Information

The results above presume that the precision of public information remains invariant while varying the precision of private information. We argue that this is unlikely to be the case when public information is endogenous through prices or other macroeconomic indicators.

To investigate the role of prices, we introduce a financial market where agents trade an asset prior to playing the coordination game. Because the dividend depends on the underlying fundamentals or the aggregate attack, the equilibrium price will convey information that is valuable in the coordination game.

Setup

As before, nature draws θ from an improper uniform distribution over the real line and each agent receives the exogenous private signal $x_i = \theta + \sigma_x \xi_i$. We avoid direct payoff linkages between the financial market and the coordination game to isolate and focus on information aggregation. Agents can be seen as interacting in two separate stages.

In the first stage agents trade over a risky asset with dividend f at price p . We adopt the convenient CARA-normal specification introduced by [Grossman and Stiglitz \(1976\)](#). We assume a constant absolute risk aversion utility function over the final wealth position generated from this portfolio choice. Thus, utility is $V(w_i) = -e^{-\gamma w_i}$ for $\gamma > 0$, where $w_i = w_0 - pk_i + fk_i$ is final wealth, w_0 is initial endowed wealth, and k_i investment in the asset.

The net supply of the asset is uncertain and not observed, given by $K^s(\varepsilon) = \sigma_\varepsilon \varepsilon$, where $\sigma_\varepsilon > 0$ and $\varepsilon \sim \mathcal{N}(0, 1)$ and independent of θ and ξ_i . As in Grossman-Stiglitz, the role of the unobserved shock ε is to introduce noise in the information revealed by the market-clearing price. In this way, σ_ε parameterizes the exogenous noise in the aggregation process.

The second stage is essentially the same as the benchmark model of the previous section: agents choose whether to attack or not; the status quo is abandoned if and only if the mass of agents attacking, A , exceeds θ ; and the payoff from this stage is $U(a_i, A, \theta) = a_i(\mathbf{1}_{A>\theta} - c)$.

The only difference is that agents now observe the price that cleared the financial market in stage 1. The regime outcome, the asset's dividend, and the payoffs from both stages are realized at the end of stage 2.

Individual asset demand and attack decisions are functions of x and p , the realizations of the private signal and the price. The corresponding aggregates are then functions of θ and p . We define an equilibrium as follows.

Definition. *An equilibrium is a price function, $P(\theta, \varepsilon)$, individual strategies for investment and attacking, $k(x, p)$ and $a(x, p)$, and their corresponding aggregates, $K(\theta, p)$ and $A(\theta, p)$, such that:*

$$k(x, p) \in \arg \max_{k \in \mathbb{R}} \mathbb{E} [V(w_0 + (f - p)k) \mid x, p] \quad (4)$$

$$K(\theta, p) = \mathbb{E} [k(x, p) \mid \theta, p] \quad (5)$$

$$K(\theta, P(\theta, \varepsilon)) = K^s(\varepsilon) \quad (6)$$

$$a(x, p) \in \arg \max_{a \in \{0, 1\}} \mathbb{E} [U(a, A(\theta, p), \theta) \mid x, p] \quad (7)$$

$$A(\theta, p) = \mathbb{E} [a(x, p) \mid \theta, p] \quad (8)$$

The equilibrium regime outcome is $R(\theta, \varepsilon) = \mathbf{1}_{A(\theta, P(\theta, \varepsilon)) > \theta}$.

Conditions (4)–(6) define a rational-expectations competitive equilibrium for stage 1. In particular, condition (4) states that individual asset demands are conditioned on all available information, including anything inferable from the price realization $p = P(\theta, \varepsilon)$, while (5) gives aggregate demand and (6) imposes market clearing. Conditions (7)–(8) then define a perfect Bayesian equilibrium for stage 2, much as in Section 2 but with the important difference that the endogenous price p replaces the exogenous public signal z .

We first consider the case where the dividend depends only on θ , in which case the only link between the financial market and the coordination game is that the former provides an endogenous public signal that is relevant for the latter. In Section 4, we consider the possibility that there is a feedback in the opposite direction as well. The first case isolates the coordinating role of prices; the second shows how this can contribute to volatility in the asset market itself.

Equilibrium Analysis

For simplicity, we let $f = \theta$ and, following [Grossman and Stiglitz \(1976\)](#), focus on linear price functions that are not perfectly revealing.⁶ Observing the price realization is then equivalent to observing a normally distributed signal with some precision $\alpha_p = \sigma_p^{-2} \geq 0$. The posterior of θ conditional on x and p is normally distributed with mean $\delta x + (1 - \delta)p$ and precision α , where $\delta = \alpha_x/\alpha$ and $\alpha = \alpha_x + \alpha_p$. It follows that individual asset demand is

$$k(x, p) = \frac{\mathbb{E}[f \mid x, p] - p}{\gamma \text{Var}[f \mid x, p]} = \frac{\delta \alpha}{\gamma} (x - p) = \frac{\alpha_x}{\gamma} (x - p),$$

and therefore aggregate demand is $K(\theta, p) = (\alpha_x/\gamma)(\theta - p)$. Market clearing $K(\theta, p) = \sigma_\varepsilon \varepsilon$ then implies

$$P(\theta, \varepsilon) = \theta - \sigma_p \varepsilon,$$

which verifies the guess of a linear price function with

$$\sigma_p = \gamma \sigma_\varepsilon \sigma_x^2. \tag{9}$$

Thus, public information improves with private information. This is the key observation of the paper and has important implications for the determination and characterization of equilibria in the coordination game: agents can use prices to better predict one another's actions.

Indeed, since stage 2 here is equivalent to the benchmark model of [Section 2](#), with the price p playing the role of the public signal z , the analysis is completed by replacing σ_z in [Proposition 1](#) with σ_p from equation (9).

Proposition 3. *In the financial market economy with exogenous dividend there are multiple equilibria if $\sigma_\varepsilon^2 \sigma_x^3 < 1/(\gamma^2 \sqrt{2\pi})$.*

In [Proposition 1](#) the noise in public information was fixed, so a sufficiently low private noise ensured uniqueness. In contrast, here better private information improves public information, and at a rate fast enough to ensure multiplicity. The result is illustrated in [Figure 3](#). In contrast to [Figure 2](#), as the private noise σ_x decreases, the public noise σ_z also decreases, eventually pushing the economy into the multiplicity region.⁷

An immediate implication is that uniqueness can no longer be seen as a small perturbation away from common knowledge: multiplicity is ensured when either σ_x or σ_ε are small, as

⁶ In Grossman and Stiglitz's setup, the perfectly revealing equilibrium seems implausible, and it is not known whether other non-linear equilibrium price functions exist.

⁷ Adding an exogenous source of public information in our model would only strengthen the case for multiplicity, which would then obtain for either low or high private noise σ_x .

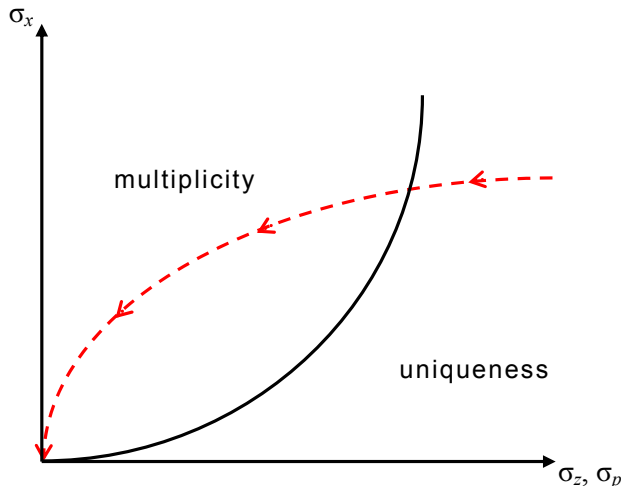


Figure 3: Endogenous information. As σ_x decreases, σ_z also decreases; multiplicity is therefore ensured for σ_x small enough.

illustrated in [Figure 1](#). Indeed, both extreme common-knowledge outcomes can be recovered as *either* noise vanishes.

Proposition 4. *Consider the limit as $\sigma_x \rightarrow 0$ for given σ_ε , or $\sigma_\varepsilon \rightarrow 0$ for given σ_x . There exists an equilibrium in which $R(\theta, \varepsilon) \rightarrow 0$ whenever $\theta \in (\underline{\theta}, \bar{\theta})$, as well as an equilibrium in which $R(\theta, \varepsilon) \rightarrow 1$ whenever $\theta \in (\underline{\theta}, \bar{\theta})$. In every equilibrium, $P(\theta, \varepsilon) \rightarrow \theta$ for all (θ, ε) .*

Our results highlight the coordinating role of prices. Because agents interact in the financial market, they can use prices to predict what others will do in the coordination game. Indeed, the better informed agents are when entering the financial market, the better able they are to predict each other's actions when leaving. Thus, improving private information *reduces* strategic uncertainty and recovers multiplicity.

This argument relies on σ_p , the endogenous public noise, falling at a rate faster than does the square root of σ_x , the exogenous private noise. This property holds here and in the cases considered below, but is sensitive to the details of the aggregation channel. In the Appendix we discuss and analyze an extension designed to highlight this point. There the dividend of the asset is imperfectly correlated with the exogenous fundamentals that are relevant for the coordination game. The idea is to introduce additional noise in the aggregation process. If one assumes that this noise remains bounded away from zero as σ_x goes to zero, then σ_p also remains bounded away from zero and hence uniqueness obtains in the limit. Nevertheless, more precise private information continues to generate more precise public information, and contributes to multiplicity over some range of parameters. Moreover, the limit result turns out to be robust to this extension for the case with an endogenous dividend, which we turn to next.

4 Price Multiplicity

Motivated by the fact that crises are likely to affect asset market returns, we now consider the case where the asset's dividend is endogenously determined by the coordination game. This may capture, in a stylized fashion, the real rate of return on peso-forwards during currency attacks, or more generally stock-market returns during economic crises. As in the case with an exogenous dividend, the precision of the information conveyed endogenously by the price increases with the precision of exogenous private information. Again, this guarantees multiplicity for small levels of noise. The novel implication here is that multiplicity emerges also in the financial price.

The model is exactly as in the previous section, except for the endogeneity of the dividend. In particular, we let the dividend be a function of the aggregate size of attack in the coordination game, $f = f(A)$. To preserve normality of the information structure, we take $f(A) = -\Phi^{-1}(A)$.

In monotone equilibria, agents attack if and only if their private signal is below some threshold $x^*(p)$, so the aggregate attack is $A(\theta, p) = \Phi(\sqrt{\alpha_x}(x^*(p) - \theta))$ and the realized dividend is $f = \sqrt{\alpha_x}(\theta - x^*(p))$. Since p is observed, agents can calculate $\tilde{p} = p/\sqrt{\alpha_x} + x^*(p)$, which represents the price of an asset that pays $\tilde{f} = f/\sqrt{\alpha_x} + x^*(p) = \theta$. We focus on equilibria with a one-to-one mapping between p and \tilde{p} , so that the observation of p is equivalent to the observation of \tilde{p} .

We guess and verify that the posterior for θ is normally distributed with mean $\delta x + (1 - \delta)\tilde{p}$ and precision α , where $\delta = \alpha_x/\alpha$ and $\alpha = \alpha_x + \alpha_p$, for some $\alpha_p = \sigma_p^{-2} \geq 0$. Individual asset demands are then given by

$$k(x, p) = \frac{\mathbb{E}[f | x, p] - p}{\gamma \text{Var}[f | x, p]} = \frac{\sqrt{\alpha_x}}{\gamma}(x - \tilde{p})$$

and aggregate demand by

$$K(\theta, p) = \frac{\sqrt{\alpha_x}}{\gamma}(\theta - \tilde{p}) = \frac{\sqrt{\alpha_x}}{\gamma} \left(\theta - \frac{p}{\sqrt{\alpha_x}} - x^*(p) \right)$$

Market clearing thus implies $\tilde{p} = \theta - \sigma_p \varepsilon$ with

$$\sigma_p = \gamma \sigma_\varepsilon \sigma_x.$$

Once again, public information improves with private information.

Since stage 2 is identical to the benchmark model except for the endogeneity of the public signal, the thresholds $\theta^*(p)$ and $x^*(p)$ must solve versions of equations (1) and (2), but with

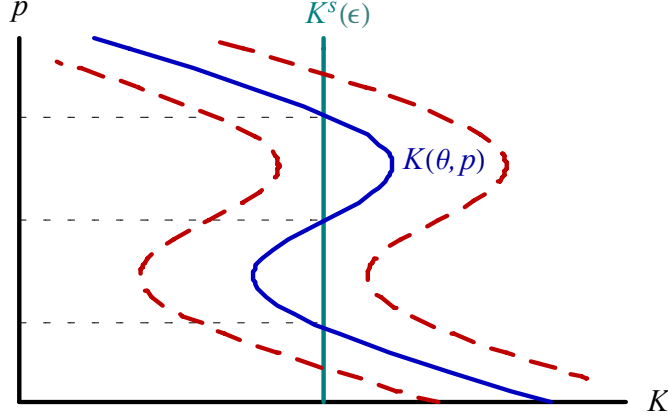


Figure 4: Backward-bending asset demand and price multiplicity.

$\tilde{p} = p/\sqrt{\alpha_x} + x^*(p)$ replacing z , and with α_p replacing α_z :

$$\theta^*(p) = \Phi \left(\sqrt{\frac{\alpha_x}{\alpha_x + \alpha_p}} \Phi^{-1}(1 - c) - \frac{\alpha_p}{\alpha_x + \alpha_p} p \right) \quad \text{and} \quad x^*(p) = \theta^*(p) + \frac{1}{\sqrt{\alpha_x}} \Phi^{-1}(\theta^*(p)). \quad (10)$$

It follows that the thresholds $\theta^*(p)$ and $x^*(p)$, and hence the asset demand $K(\theta, p)$, are uniquely determined. Also, $K(\theta, p)$ is continuous in p with $\lim_{p \rightarrow -\infty} K(\theta, p) = \infty$ and $\lim_{p \rightarrow \infty} K(\theta, p) = -\infty$.

Thus, the market clearing condition $K(\theta, p) = K^s(\varepsilon)$ always admits at least one equilibrium price. However, since the dividend $f = \sqrt{\alpha_x}(\theta - x^*(p))$ is increasing in p , asset demand is not necessarily decreasing in p . Indeed,

$$\text{sign} \left(\frac{\partial K(\theta, p)}{\partial p} \right) = -\text{sign} \left(\frac{\sqrt{\alpha_x}}{\alpha_p} - \phi(\Phi^{-1}(\theta^*)) \right),$$

so that demand is non-monotone if and only if $\sqrt{\alpha_x}/\alpha_p < \sqrt{2\pi}$, or equivalently $\sigma_\varepsilon^2 \sigma_x < 1/(\gamma^2 \sqrt{2\pi})$, that is, when either noise is small.

A backward-bending demand curve is possible here because of the two-way feedback between the financial market and the coordination game. A higher price realization makes agents in the second stage less inclined to attack. A smaller attack raises the asset dividend. Provided that this effect is strong enough, the demand for the asset can increase with its price over some region.

The solid line in [Figure 4](#) illustrates a case where a backward-bending demand meets supply three times. The dashed lines show parallel shifts with changes in θ ; only the low (high) price equilibrium remains for low (high) enough values of θ relative to ε . Thus, when demand is non-monotone, there is a non-empty set of (θ, ε) for which there are three market clearing prices. Multiplicity in the price function then feeds into multiplicity in the coordination game,

by composing $x^*(p)$ and $\theta^*(p)$ with $P(\theta, \varepsilon)$.

Proposition 5. *In the financial market economy with endogenous dividend there are multiple equilibria if $\sigma_\varepsilon^2 \sigma_x < 1/(\gamma^2 \sqrt{2\pi})$. Multiplicity then emerges in both the regime outcome $R(\theta, \varepsilon)$ and the price function $P(\theta, \varepsilon)$.*

Note that multiplicity does not emerge in individual strategies for given price realization. In this sense, price multiplicity is crucial for equilibrium multiplicity. To gain some intuition for this result, consider the common-knowledge case with $\sigma_x = 0$. Then $x = \theta$, $p = f = -\Phi^{-1}(A)$, and therefore $\theta < A$ if and only if $x < \Phi(-p)$; so it is optimal to attack if and only if $x < \Phi(-p)$ and individual strategies are uniquely determined as functions of (x, p) . Indeed, these common-knowledge outcomes are approached as noise vanishes.

Proposition 6. *Consider the limit as $\sigma_x \rightarrow 0$ for given σ_ε , or $\sigma_\varepsilon \rightarrow 0$ for given σ_x . There is an equilibrium in which $R(\theta, \varepsilon) \rightarrow 0$ and $P(\theta, \varepsilon) \rightarrow \infty$ whenever $\theta \in (\underline{\theta}, \bar{\theta})$, as well as an equilibrium in which $R(\theta, \varepsilon) \rightarrow 1$ and $P(\theta, \varepsilon) \rightarrow -\infty$ whenever $\theta \in (\underline{\theta}, \bar{\theta})$.*

Proof. See Appendix. ■

In our economy the financial price plays three roles for market participants. First, it affects the cost of acquiring a given asset—the standard substitution effect present in any model. Second, it signals the dividend of the asset—the usual information-aggregation role highlighted by the rational expectations literature. Third, it affects the outcome in the coordination game and thereby *changes* the dividend of the asset itself—the novel coordination role for prices identified in this paper.

This third effect is the source of price multiplicity in our model. It has the interesting implication that financial markets can have a destabilizing effect. Indeed somewhat paradoxically, this effect is highest in situations of low exogenous noise. This is in contrast to standard Grossman-Stiglitz environments where lower noise (e.g. supply shocks or noisy traders) leads to lower volatility.

To the best of our knowledge, our result on price multiplicity is new. [Genotte and Leland \(1990\)](#) and [Barlevy and Veronesi \(2003\)](#) find multiple equilibrium prices in noisy rational-expectation models, but the source of multiplicity there is entirely different. In these papers, the dividend is exogenous and the price does not play any coordinating role. Instead, multiplicity obtains from non-linearities in information aggregation.⁸

Also, our result was obtained in a particular context, but is likely to apply more generally. Indeed, [Hellwig, Mukherji and Tsyvinski \(2005\)](#) verify that this multiplicity result also holds in a currency-crisis model where the coordination game is embedded in the financial market.

⁸In particular, informed traders interact with uninformed traders and multiplicity originates from the inference problem faced by the latter: the uninformed agents' demand for the asset can turn backwards when they interpret an increase in the price as an indication of high demand from the informed agents.

5 Observing One Another

In this section, we remove the financial market and examine instead situations where information originates *within* the coordination game itself: agents observe a public signal about the aggregate attack. Such a feature seems relevant for thinking about bank runs, where widespread news coverage of a panic may spur other depositors to draw on their own accounts. More generally, during times of crises it is unlikely that individuals are in the dark about what others are doing. Quite the contrary, they are most likely looking avidly over their shoulders. Indeed, in coordination models the desire for such direct information is most natural—agents are keen to learning about the actions of others since this affects their payoffs $U(a, A, \theta)$ directly.

An additional benefit is that this framework allows us to study information aggregation with a minimal modification of exogenous-information Morris-Shin benchmark. It also bridges a gap between coordination models—that stress complementarities in actions—and herding models—which stress the observation of others’ actions.

The model is identical to the benchmark model from [Section 2](#) except that the public signal z is replaced with

$$y = S(A, \varepsilon),$$

where ε is noise independent of θ and ξ . To preserve normality of the information structure and obtain closed-form solution, we take $S(A, \varepsilon) = \Phi^{-1}(A) + \sigma_\varepsilon \varepsilon$ and $\varepsilon \sim \mathcal{N}(0, 1)$.⁹ The information structure is parameterized by $(\sigma_x, \sigma_\varepsilon)$.

We assume that agents can condition their decision to attack on this indicator of *contemporaneous* aggregate behavior. Taken literally this clashes with standard game-theory, but we do not take this literally. Rather, we think this captures in a parsimonious way the idea that many act based on some information about others’ actions, or are able to revise their actions based on such information.¹⁰ In any case, an earlier version of this paper ([Angeletos and Werning, 2004](#)) developed a sequential variant that delivers similar results, while allowing standard game-theoretic equilibrium concepts.¹¹

⁹ This convenient specification was introduced by [Dasgupta \(2003\)](#) in a different environment.

¹⁰ [Minelli and Polemarchakis \(2003\)](#) develop a similar theme and argue that “At a Nash equilibrium of a game with uncertainty and private information [...] individuals do not extract information from the acts of other individuals in the same round of play; this takes literally the simultaneity of moves. But it is naive.”

¹¹ The population is divided into two groups, ‘early’ and ‘late’ agents. Neither group observes contemporaneous activity. Early agents move first, on the basis of their private information alone. Late agents move second, on the basis of their private information as well as a noisy public signal about the aggregate actions of early agents. Moreover, the case with simultaneous moves studied here is approached in the sequential variant as the fraction of early agents goes to zero.

Definition. An equilibrium consists of an endogenous signal $y = Y(\theta, \varepsilon)$, an individual attack strategy $a(x, y)$, and an aggregate attack $A(\theta, y)$, that satisfy:

$$a(x, y) \in \arg \max_{a \in \{0,1\}} \mathbb{E}[U(a, A(\theta, y), \theta) \mid x, y] \quad (11)$$

$$A(\theta, y) = \mathbb{E}[a(x, y) \mid \theta, y] \quad (12)$$

$$y = S(A(\theta, y), \varepsilon) \quad (13)$$

Just as in the asset market model of [Section 3](#), our equilibrium definition is a hybrid of rational-expectations and perfect Bayesian equilibrium concepts. Equation (11) requires the attack choice to be optimal given all available information, including the realized signal y of the aggregate attack. Equation (12) aggregates. Equation (13) imposes the rational-expectations consistency requirement, the signal must be generated by individual actions that are, in turn, dependent on it.

In monotone equilibria, an agent attacks if and only if $x \leq x^*(y)$ and the status quo is abandoned if and only if $\theta \leq \theta^*(y)$, so an equilibrium is identified with a triplet of functions $x^*(y)$, $\theta^*(y)$, and $Y(\theta, \varepsilon)$. As before, we focus on equilibria that preserve normality of the information structure.¹²

The model behaves in a similar way to the endogenous dividend model from [Section 4](#). Here agents receive a direct signal of the attack A , while there the price was an indirect signal of the attack A , but both y and p convey the same information in equilibrium. Indeed, the noise in the endogenous public information generated by y turns out to be

$$\sigma_y = \sigma_x \sigma_\varepsilon,$$

implying that multiplicity once again survives for small levels of noise.

Proposition 7. *In the economy with observable actions an equilibrium always exists. If $\sigma_\varepsilon^2 \sigma_x < 1/\sqrt{2\pi}$ there are multiple equilibria.*

Proof. See Appendix. ■

Indeed, when multiplicity arises it is with respect to aggregate outcomes and not individual strategies, as in [Section 4](#). Extreme common-knowledge outcomes can be obtained as either noise vanishes, so that non-fundamental volatility is greatest near perfect-information (as in [Proposition 4](#) and [Proposition 6](#)).

¹² Formally, we consider equilibria such that $G(Y(\theta, \varepsilon)) = \lambda_1 \theta + \lambda_2 \varepsilon$ for some strictly monotone function G and non-zero coefficients λ_1, λ_2 .

6 Non-fundamental Volatility

We now investigate the role of the information structure for *non-fundamental* volatility, that is, volatility conditional on θ . We are interested in two sources of non-fundamental volatility. First, when there are multiple equilibria, sunspot variables may be used as coordination devices and thus contribute to volatility. Second, when the equilibrium is unique its dependence on the noise shock ε generates volatility.

Recall that with *exogenous* information, multiplicity disappears when agents observe the fundamentals with small private noise ([Proposition 1](#)). Thus, there is no sunspot volatility when σ_x is small enough. Moreover, as $\sigma_x \rightarrow 0$, the size of the attack and the regime outcome become independent of ε ([Proposition 2](#)). Thus, all non-fundamental volatility vanishes.¹³

With *endogenous* information, the impact of private noise is quite different. We first summarize the implications of our results for the sunspot source of non-fundamental volatility. A reduction in σ_x may take the economy from the uniqueness to the multiplicity region, introducing sunspots ([Proposition 3](#), [Proposition 5](#) and [Proposition 7](#)). Indeed, potential sunspot volatility is greatest when either noise vanishes, $\sigma_x \rightarrow 0$ or $\sigma_\varepsilon \rightarrow 0$, in the sense that the regime's fate can become entirely dependent on the sunspot realization ([Proposition 4](#) and [Proposition 6](#)). Moreover, when the dividend is endogenous, sunspot volatility also emerges in prices ([Proposition 5](#)), and again becomes most extreme as noise vanishes ([Proposition 6](#)).

We now turn to the second source of non-fundamental volatility and argue that, with endogenous information, less noise may increase volatility even without entering the region of multiple equilibria: when the equilibrium is unique, a reduction in σ_x or σ_ε can increase the sensitivity of equilibrium outcomes to the exogenous shock ε .

To show this result, we focus on the two financial-market models and proceed as follows. The regime is abandoned if and only if $\theta \leq \theta^*(p)$ with $p = P(\theta, \varepsilon)$. As long as the equilibrium is unique, $\theta^*(p)$ is continuously decreasing in p , and the price function $P(\theta, \varepsilon)$ is continuously increasing in θ . Hence, the regime is abandoned if and only if $\theta \leq \hat{\theta}(\varepsilon)$, where $\hat{\theta}(\varepsilon)$ is the unique solution to $\hat{\theta}(\varepsilon) = \theta^*(P(\hat{\theta}(\varepsilon), \varepsilon))$. Solving for $\hat{\theta}(\varepsilon)$ in this way we obtain

$$\hat{\theta}(\varepsilon) = \Phi \left(\psi + \frac{\sigma_p}{\sigma_x} \varepsilon \right),$$

where $\psi \equiv (1 + 1/\sigma_p^2)^{1/2} \Phi^{-1}(1 - c)$. It follows that

$$\frac{\partial \hat{\theta}}{\partial \varepsilon} = \frac{\sigma_p}{\sigma_x} \phi(\Phi^{-1}(\hat{\theta}))$$

¹³ [Morris and Shin \(2003, 2004\)](#) study the volatility of unique equilibria further in coordination games with exogenous information.

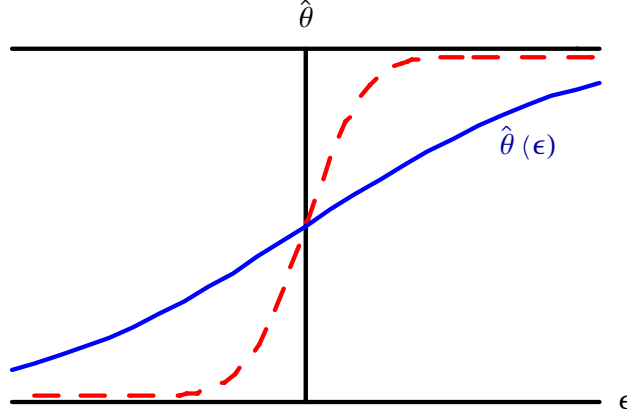


Figure 5: The regime-change threshold $\hat{\theta}$ as a function of the shock ϵ . The dashed line corresponds to lower level of noise than the solid line.

and therefore $\hat{\theta}(\epsilon)$ satisfies a single-crossing property with respect to σ_p/σ_x . In this sense, the sensitivity of the regime outcome to the non-fundamental shock ϵ increases with σ_p/σ_x .

With exogenous dividend, $\sigma_p/\sigma_x = 1/(\gamma\sigma_\epsilon\sigma_x)$ and therefore the sensitivity of $\hat{\theta}(\epsilon)$ to ϵ increases with a reduction in either noise. This result is illustrated in [Figure 5](#), which depicts the threshold $\hat{\theta}(\epsilon)$, with the dashed line corresponding to a lower σ_x or σ_ϵ than the solid one.

With endogenous dividend, $\sigma_p/\sigma_x = 1/(\gamma\sigma_\epsilon)$. The impact of public noise is identical to the exogenous dividend case: sensitivity increases with σ_ϵ . In contrast, the sensitivity is now invariant to the amount of private noise σ_x . This result still contrasts with the case of exogenous information, where one can show that sensitivity is reduced when private information improves (the result in [Proposition 2](#) can be seen as the extreme case).

Consider next the implications for price volatility. With exogenous dividend we have $p = \theta - \gamma\sigma_\epsilon\sigma_x^2\epsilon$. The impact of noise on the sensitivity of the price to ϵ is then exactly as in Grossman-Stiglitz: a reduction in either σ_x or σ_ϵ reduces price volatility.

In contrast, when the dividend is endogenous, we have $p = f(A) - \gamma\sigma_\epsilon\epsilon$. Conditional on the size of the attack—or, equivalently here, on the dividend—the volatility of the price decreases with a reduction in σ_ϵ and is independent of σ_x . But since the attack A is a function of ϵ , a reduction in σ_ϵ may have an ambiguous overall effect on price volatility. Indeed, we have verified numerically that price volatility can increase with a reduction in σ_ϵ . Thus, the coordinating role of prices identified in [Section 4](#) can generate volatility in asset markets even without multiplicity.

We conclude that less noise may increase volatility in both the regime outcome and the asset price even when the equilibrium is unique. The results on equilibrium multiplicity may be viewed as extreme versions of this effect.

7 Discussion

This paper emphasizes the importance of endogenous public information for understanding multiplicity and volatility in situations where coordination is important. We model this by letting agents observe either (i) the price of a financial asset, or (ii) a direct noisy signal of others' activity in the coordination game.

Our key result is that the precision of endogenous public information increases with the precision of exogenous private information. This feature is likely to be very robust and carries with it the important implication that lower levels of private noise do not necessarily contribute towards uniqueness.

Whether this effect is strong enough to ensure multiplicity in the limit is sensitive to the details of the aggregation process, for it depends on whether the precision of public information increases faster than the square root of the precision of private information. Although this turns out to hold in all the cases studied above, it need not obtain in some variations of our asset-market model that introduce additional noise in the aggregation process.

Nevertheless, we believe that the cases presented here, and the result that information aggregation ensures multiplicity for small enough noise, provide an important benchmark. Indeed, the simplest model featuring information aggregation selects N individuals at random to be on a 'talk show'. Those on the show broadcast their signals to the rest of the population. This amounts to generating a public signal $z = \theta + \sigma_z \varepsilon$ with $\sigma_z = \sigma_x / \sqrt{N}$. In this case, public communication links the precision of private and public information in such a way that multiplicity is once again ensured for small enough noise. We conclude that, while some extensions may qualify our limit results, they are unlikely to modify our main point that endogenous public information is important for understanding volatility.

Appendix

Proof of Proposition 2

Consider the limit as $\sigma_x \rightarrow 0$ for given σ_z , or $\sigma_z \rightarrow \infty$ for given σ_x . In either case, $\alpha_z/\sqrt{\alpha_x} \rightarrow 0$ and $\alpha_z/\alpha_x \rightarrow 0$. Condition (3) then implies that $\theta^*(z) \rightarrow \hat{\theta} = 1 - c$ for any z , meaning that the regime outcome is unique and independent of the non-fundamental shock ε . Similarly, $x^*(z) \rightarrow \hat{x}$, where $\hat{x} = \hat{\theta}$ if we consider the limit $\sigma_x \rightarrow 0$, whereas $\hat{x} = \hat{\theta} + \sigma_x \Phi^{-1}(\hat{\theta})$ if we instead consider the limit $\sigma_z \rightarrow \infty$.

Proof of Proposition 4

In direct analogy to (3), the equilibrium correspondence here is given by

$$\Theta^*(p) = \{\theta^* \in (0, 1) : p = Q(\theta^*)\},$$

where

$$Q(\theta^*) \equiv \theta^* - \frac{\sqrt{\alpha_x}}{\alpha_p} \Phi^{-1}(\theta^*) + \sqrt{\frac{\alpha_x + \alpha_p}{\alpha_p^2}} \Phi^{-1}(1 - c). \quad (14)$$

Note that $\lim_{\theta^* \rightarrow 0} Q(\theta^*) = \infty$ and $\lim_{\theta^* \rightarrow 1} Q(\theta^*) = -\infty$. Moreover, whenever $\alpha_p/\sqrt{\alpha_x} > 1/\sqrt{2\pi}$, there exists a non-empty interval $(\theta_1, \theta_2) \subset (0, 1)$ such that Q is decreasing outside this interval, and increasing inside it, as illustrated by the dashed line in Figure 6. It follows that $\Theta^*(p)$ is non-empty and has at most three elements.

Any monotone selection from $\Theta^*(p)$ defines an equilibrium. Let $\theta_l^*(p) = \min \Theta^*(p)$ and $\theta_h^*(p) = \max \Theta^*(p)$; these represent the least and most aggressive equilibria. Consider now the limit as $\sigma_x \rightarrow 0$ or $\sigma_\varepsilon \rightarrow 0$. Using (9), we have $\sigma_p = \gamma \sigma_\varepsilon \sigma_x^2 \rightarrow 0$, $\sqrt{\alpha_x}/\alpha_p = \gamma^2 \sigma_\varepsilon^2 \sigma_x^3 \rightarrow 0$, and therefore $Q(\theta^*) \rightarrow \theta^*$ for all $\theta^* \in (0, 1)$. It follows that $\Theta^*(p)$ converges to $\{1\}$ for $p \leq 0$, to $\{0, p, 1\}$ for $p \in (0, 1)$, and to $\{0\}$ for $p \geq 1$, as illustrated by the solid line in Figure 6. By

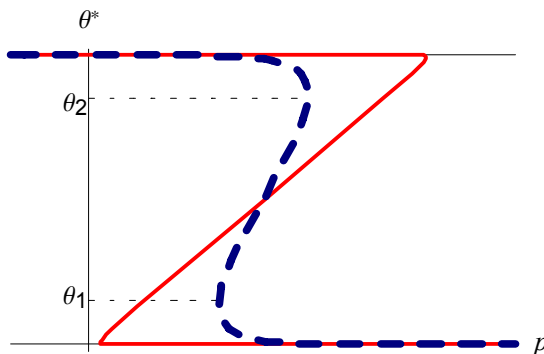


Figure 6: The equilibrium correspondence as noise vanishes.

implication,

$$\theta_l^*(p) \rightarrow \begin{cases} 1 & \text{for } p < 0 \\ 0 & \text{for } p > 0 \end{cases} \quad \text{and} \quad \theta_h^*(p) \rightarrow \begin{cases} 1 & \text{for } p < 1 \\ 0 & \text{for } p > 1 \end{cases}$$

At the same time, $\sigma_p \rightarrow 0$ implies that, for any (θ, ε) , $P(\theta, \varepsilon) \rightarrow \theta$. It follows that, for any $\theta \in (0, 1)$ and any ε , $\theta - \theta_l^*(P(\theta, \varepsilon)) \rightarrow \theta > 0$ and $\theta - \theta_h^*(P(\theta, \varepsilon)) \rightarrow \theta - 1 < 0$, which completes the proof.

Proof of Proposition 6

Market clearing requires $\tilde{p} = p/\sqrt{\alpha_x} + x^*(p)$. Using (10), this reduces to $\tilde{p} = F(p)$, where

$$F(p) \equiv \Phi\left(\psi - \frac{\alpha_p}{\alpha_x + \alpha_p}p\right) + \frac{1}{\sqrt{\alpha_x}}\psi + \frac{\sqrt{\alpha_x}}{\alpha_x + \alpha_p}p$$

and $\psi \equiv \sqrt{\frac{\alpha_x}{\alpha_x + \alpha_p}}\Phi^{-1}(1 - c)$ and $\alpha_p = \alpha_x\alpha_\varepsilon/\gamma^2$. Consider the correspondence

$$\mathcal{P}(\tilde{p}) = \{ p : \tilde{p} = F(p) \}.$$

Any monotone selection P^* from this correspondence defines an equilibrium price function by letting $P(\theta, \varepsilon) = P^*(\theta - \sigma_p\varepsilon)$. Note that $\lim_{p \rightarrow -\infty} F(p) = -\infty$ and $\lim_{p \rightarrow \infty} F(p) = \infty$, which together with the continuity of F ensures that $\mathcal{P}(\tilde{p})$ is always non-empty. Moreover, whenever $\alpha_p/\sqrt{\alpha_x} > 1/\sqrt{2\pi}$, there exists a non-empty interval $(p_1, p_2) \subset \mathbb{R}$ such that F is increasing outside this interval, and decreasing inside it. (Note that $F(p) = \theta - \gamma\sigma_x K(\theta, p)$ and hence the non-monotonicity of F simply reflects the non-monotonicity of asset demand.)

Take $P_l^*(\tilde{p}) = \min \mathcal{P}^*(\tilde{p})$ and $P_h^*(\tilde{p}) = \max \mathcal{P}^*(\tilde{p})$, let $P_l(\theta, \varepsilon) = P_l^*(p - \sigma_p\varepsilon)$ and $P_h(\theta, \varepsilon) = P_h^*(p - \sigma_p\varepsilon)$, consider the limit as $\sigma_x \rightarrow 0$ or $\sigma_\varepsilon \rightarrow 0$. It can be shown that

$$P_l^*(\tilde{p}) \rightarrow \begin{cases} +\infty & \text{for } \tilde{p} < 1 \\ -\infty & \text{for } \tilde{p} > 1 \end{cases} \quad \text{and} \quad P_h^*(\tilde{p}) \rightarrow \begin{cases} +\infty & \text{for } \tilde{p} < 0 \\ -\infty & \text{for } \tilde{p} > 0 \end{cases}$$

At the same time, $\sigma_p \rightarrow 0$ implies that, for any (θ, ε) , $\tilde{p} \rightarrow \theta$. It follows that, for any $\theta \in (0, 1)$ and any ε , $P_l(\theta, \varepsilon) \rightarrow -\infty$ and $\theta - \theta^*(P_l(\theta, \varepsilon)) \rightarrow \theta > 0$, while $P_h(\theta, \varepsilon) \rightarrow +\infty$ and $\theta - \theta^*(P_h(\theta, \varepsilon)) \rightarrow \theta - 1 < 0$, which completes the proof.

Proof of Proposition 7

Given that an agent attacks if and only if $x \leq x^*(y)$, the aggregate attack is $A(\theta, y) = \Phi(\sqrt{\alpha_x}(x^*(y) - \theta))$. Condition (13) then implies that the signal satisfies

$$x^*(y) - \sigma_x y = \theta - \sigma_x \sigma_\varepsilon \varepsilon. \quad (15)$$

Note that (15) is a mapping between y and $z = \theta - \sigma_x \sigma_\varepsilon \varepsilon$. Define the correspondence

$$\mathcal{Y}(z) = \{y \in \mathbb{R} \mid x^*(y) - \sigma_x y = z\}.$$

We will later show that $\mathcal{Y}(z)$ is non-empty and examine when it is single- or multi-valued.

Take any function $\tilde{Y}(z)$ that is a selection from this correspondence, $\tilde{Y}(z) \in \mathcal{Y}(z)$ for all z , and let $Y(\theta, \varepsilon) = \tilde{Y}(\theta - \sigma_x \sigma_\varepsilon \varepsilon)$. The observation of $y = Y(\theta, \varepsilon)$ is then equivalent to the observation of $z = \theta - \sigma_x \sigma_\varepsilon \varepsilon = Z(y)$, where $Z(y) \equiv x^*(y) - \sigma_x y$ and

$$\sigma_z = \sigma_x \sigma_\varepsilon. \quad (16)$$

That is, it is as if agents observe a normally distributed public signal with precision proportional to precision of exogenous private information.

An agent attacks if and only if $x \leq x^*(y)$, where $x^*(y)$ solves the indifference condition

$$\Phi\left(\sqrt{\alpha_x + \alpha_z}\left(\theta^*(y) - \frac{\alpha_x}{\alpha_x + \alpha_z}x^*(y) - \frac{\alpha_z}{\alpha_x + \alpha_z}Z(y)\right)\right) = c. \quad (17)$$

The regime in turn is abandoned if and only if $\theta \leq \theta^*(y)$, where $\theta^*(y)$ solves $A(\theta, y) = \theta$, or equivalently

$$x^*(y) = \theta^*(y) + \frac{1}{\sqrt{\alpha_x}}\Phi^{-1}(\theta^*(y)). \quad (18)$$

Using $Z(y) = x^*(y) - \sigma_x y$ and substituting $x^*(y)$ from (18) into (17), we get

$$\theta^*(y) = \Phi\left(\sqrt{\frac{\alpha_x}{\alpha_x + \alpha_z}}\Phi^{-1}(1 - c) + \frac{\alpha_z}{\alpha_x + \alpha_z}y\right), \quad (19)$$

which together with (18) determines a unique pair $\theta^*(y)$ and $x^*(y)$. The strategy $a(x, y)$ and the corresponding aggregate $A(x, y)$ are thus uniquely determined.

We return to the equilibrium correspondence $\mathcal{Y}(z)$. Using (18) and (19) this reduces to $\mathcal{Y}(z) = \{y : F(y) = z\}$, where

$$F(y) \equiv \Phi\left(\frac{\alpha_z}{\alpha_x + \alpha_z}y + q\right) + \frac{1}{\sqrt{\alpha_x}}\left(-\frac{\alpha_x}{\alpha_x + \alpha_z}y + q\right)$$

and $q \equiv \sqrt{\alpha_x/(\alpha_x + \alpha_z)}\Phi^{-1}(1 - c)$. Note that $F(y)$ is continuous in y , and $F(y) \rightarrow -\infty$ as $y \rightarrow \infty$, and $F(y) \rightarrow \infty$ as $y \rightarrow -\infty$, which guarantees that $\mathcal{Y}(z)$ is non-empty and therefore an equilibrium always exists. Next, note that

$$\text{sign}(F'(y)) = -\text{sign}\left(1 - \frac{\alpha_z}{\sqrt{\alpha_x}}\phi\left(\frac{\alpha_z}{\alpha_x + \alpha_z}y + q\right)\right)$$

and therefore $F(y)$ is globally monotonic if and only if $\alpha_z/\sqrt{\alpha_x} \leq \sqrt{2\pi}$, in which case $\mathcal{Y}(z)$ is single valued. If instead $\alpha_z/\sqrt{\alpha_x} > \sqrt{2\pi}$, there is a non-empty interval (\underline{z}, \bar{z}) within which $\mathcal{Y}(z)$ takes three values. Different (monotone) selections then sustain different equilibria. Using $\alpha_z = \alpha_\varepsilon\alpha_x$ from (16) completes the proof.

Extension with Noisy Dividend

Multiplicity obtains in the limit if the precision of public information increases at a faster rate than the square root of the precision of private information. Here we show that this property need not obtain in some variations of our asset-market model that introduce additional noise in the aggregation process.

The model is as in Section 3 or Section 4, except that the dividend is not perfectly correlated with the fundamental or the coordination outcome: $f = \theta + \eta$ in the one case, and $f = f(A) + \eta$ in the other, where $\eta \sim \mathcal{N}(0, \sigma_\eta^2)$ is independent of $(\theta, \xi, \varepsilon)$.

The equilibrium price continues to aggregate information, but the risk introduced by η limits the sensitivity of asset demands to changes in expected excess returns. With exogenous dividend, this effect implies a upper bound on the precision of the information revealed by the price. As a result, for any given $(\sigma_\eta, \sigma_\varepsilon) > 0$, multiplicity holds for an intermediate range of σ_x , but not in the limit as $\sigma_x \rightarrow 0$. With endogenous dividend, however, the sensitivity of the dividend itself to θ increases with the precision of private information, overturning the previous dampening effect. As a result, multiplicity now obtains even in the limit as $\sigma_x \rightarrow 0$.

Finally, with either exogenous or endogenous dividend, less noise in the form of smaller σ_ε or σ_η contributes to multiplicity. In particular, for any $(\sigma_x, \sigma_\varepsilon)$ for which multiplicity was obtained when $\sigma_\eta = 0$, multiplicity is again ensured as long as σ_η is positive but small enough.

Proposition A. (i) When $f = \theta + \eta$, a unique equilibrium survives for sufficiently small σ_x , given $(\sigma_\eta, \sigma_\varepsilon)$. (ii) When $f = f(A) + \eta$, multiple equilibria exist for sufficiently small σ_x , given $(\sigma_\eta, \sigma_\varepsilon)$. (iii) In either case, the region of $(\sigma_x, \sigma_\varepsilon)$ for which the equilibrium is unique vanishes as $\sigma_\eta \rightarrow 0$.

Proof. Part (i). Postulating that the posterior for θ conditional on (x, p) is normally distributed with mean $\delta x + (1 - \delta)p$ and precision α , where $\delta = \alpha_x/\alpha$ and $\alpha = \alpha_x + \alpha_p$, we have that

individual asset demands are given by

$$k(x, p) = \frac{\mathbb{E}[f | x, p] - p}{\gamma \text{Var}[f | x, p]} = \frac{\delta(x - p)}{\gamma(\alpha^{-1} + \sigma_\eta^2)}.$$

It follows that the equilibrium price is $p = \theta - \sigma_p \varepsilon$, where $\sigma_p = \gamma(\sigma_x^2 + \sigma_\eta^2/\delta)\sigma_\varepsilon$. Since $\delta \in [0, 1]$ and $\sigma_x > 0$, σ_p is bounded from below by $\gamma\sigma_\eta^2\sigma_\varepsilon > 0$ and hence $\sigma_x < (\gamma\sigma_\eta^2\sigma_\varepsilon)^2\sqrt{2\pi}$ suffices for the equilibrium to be unique.

Part (ii). We now postulate that the posterior for θ is normally distributed with mean $\delta x + (1 - \delta)\tilde{p}$ and precision α , where $\tilde{p} = p/\sqrt{\alpha_x} + x^*(p)$, $\delta = \alpha_x/\alpha$, and $\alpha = \alpha_x + \alpha_p$. It follows that

$$k(x, p) = \frac{\mathbb{E}[f | x, p] - p}{\gamma \text{Var}[f | x, p]} = \frac{\sqrt{\alpha_x}\delta(x - \tilde{p})}{\gamma(\alpha_x\alpha^{-1} + \sigma_\eta^2)}$$

and therefore $\tilde{p} = \theta - \sigma_p \varepsilon$, where

$$\sigma_p = \frac{1 + \sigma_\eta^2}{1 - \gamma\sigma_\eta^2\sigma_\varepsilon} \gamma\sigma_\varepsilon\sigma_x.$$

Hence, a higher σ_η again makes it harder for multiple equilibria to exist, nevertheless multiplicity is ensured by a sufficiently small σ_x or σ_ε .

Part (iii). This follows immediately from the fact that, for any given $(\sigma_x, \sigma_\varepsilon)$, σ_p is decreasing in σ_η , with $\sigma_p \rightarrow 0$ as $\sigma_\eta \rightarrow 0$. ■

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