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**FINANCIAL CONTRACTING
ALONG THE BUSINESS CYCLE**

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Abstract

The paper investigates the effects of macroeconomic conditions on firms' capital structure. We introduce a repeated lender-borrower interaction that allows for debt and equity financing to co-exist as optimal securities in every period. The presence of asymmetric information in the market for loans is responsible for endogenous fluctuations to take place. It is possible to state sufficient conditions for the overall economy debt-equity ratio to exhibit a counter-cyclical behavior.

This result is widely supported by several recent empirical finance works.

Keywords: Optimal financial contracts, endogenous fluctuations.

JEL Classification: D92, E33, G33.

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