



MAGYAR NEMZETI BANK
THE CENTRAL BANK OF HUNGARY

RESEARCH

BESS at MNB (MNB-CEU)

Business Cycle Dynamics under Rational Inattention

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Time: 15:15 pm, Wednesday, 23rd March 2011

Venue: MNB-Visitor Centre (1054 Budapest, Szabadsag ter 8.)

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Abstract

We develop a dynamic stochastic general equilibrium model with rational inattention by households and firms. Consumption responds slowly to interest rate changes because households decide to pay little attention to the real interest rate. Prices respond quickly to some shocks and slowly to other shocks. The mix of fast and slow responses of prices to shocks matches the pattern found in the empirical literature. Changes in the conduct of monetary policy yield very different outcomes than in models currently used at central banks because systematic changes in policy cause reallocation of attention by decision-makers in households and firms.

Keywords: information choice, rational inattention, monetary policy, business cycles. (JEL: D83, E31, E32, E52).

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