BOSTON COLLEGE

Laura Veronika Gati <gati@bc.edu>

connecting after today's chat

3 messages

Laura Veronika Gati <gati@bc.edu> Thu, Nov 12, 2020 at 7:06 PM
To: eusepi73@yahoo.com

Hi Stefano,

It was really nice talking to you today and hearing your talk. I wanted to reach out to ask some follow-up questions and just to continue our conversation.

First of all, would you mind sharing today's slides with me?

Second, I think you got a couple of questions that are very typical - I also keep getting them every time I present my work. The first one was about why the New Keynesian (NK) model does not feature the standard recursive form of IS and Phillips curves. Could one answer that question by saying that the law of iterated expectations (LIE) does not hold for the aggregate expectations operator? I mean that \hat{E}^i fulfills the LIE, but \hat{E} doesn't because individual i does not know the expectations of all other individuals.

The second big question was how one can do optimal policy when the model is subject to the Lucas critique. I think you gave a great answer, but this is still a problem for the learning literature in general. Have you thought about ways to reintroduce at least elements of optimality into this type of expectation formation to overcome the Lucas critique, at least partially? This is a question I keep thinking about, also for future work. (I know the Cho and Matsui paper about inductive expectations which does exactly this, but I'm not sure that paper has been very widely received.)

Also, just to be sure, I'm sending you the latest version of my paper - I don't know which version Bruce got a hold of.

Best,
Laura

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1256K

stefano eusepi <eusepi73@yahoo.com> Thu, Nov 12, 2020 at 10:03 PM
To: Laura Veronika Gati <gati@bc.edu>

hi Laura,

very nice meeting you too!

yes of course you are right and law of iterated expectations does not apply; normally people do not question the equations but of course you never know in the seminar. Regardless, the Euler equation is not the optimal decision rule although it might converge to it in RE but only in certain cases! Bruce has an example in his job market paper.

And, about the Lucas critique, in a model like yours of ours in the anchored paper that is not really much of a constraint because the gain is endogenous and it responds to policy. But you

do more by computing the incentive to deviate from the rule in a Nash-like equilibrium: similar to what we do in the anchored paper but even clearer in Marcet and Nicolini where they solve for the gain consistent with the policy regime [check it out]

I attach the slides,

cheers
Stefano

[Quoted text hidden]

2 attachments

Eusepi_BC.pdf
1520K

Limits_EGP.pdf
760K

Laura Veronika Gati <gati@bc.edu> Thu, Nov 12, 2020 at 10:05 PM
To: stefano eusepi <eusepi73@yahoo.com>

This is great, thank you Stefano!
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Laura