Learning and Judgment Shocks in U.S. Business Cycles*

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Abstract

This paper examines the role of judgment shocks in combination with other structural shocks in explaining post-war economic volatility within the context of a New Keynesian model. Agents form expectations using constant gain learning then augment these forecasts with judgment. These judgments may be interpreted as a reaction to current news stories or policy announcements that would influence people's expectations. I allow for the possibility that these judgments be informatively based on information about structural shocks, but judgment itself may also be subject to its own stochastic shocks. I estimate a standard New Keynesian model that includes these shocks using Bayesian simulation methods. To aid in identifying expectational shocks from other structural shocks I include data on professional forecasts along with data on output gap, inflation, and interest rates.

Keywords: Learning, judgment, add-factors, New Keynesian model, Metropolis-Hastings.
JEL classification: C13, E31, E50.

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