The New Keynesian Transmission Mechanism

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Intro 1: Motivation

- The New Keynesian 3-equation model is the minimal model designed to capture the intuition of demand-driven fluctuations in output and inflation through intertemporal substitution
- Main vehicle for discussions centered around this intuition, e.g. monetary policy
- Benchmark for adding other demand-channels, such as heterogeneity in MPC
- Teaching device

Intro 2: What we do

- We study how the results of the 3-equation model is affected by adding 2 types of labor markets
  - Competitive
  - Rigid
- We show that the competitive labor market model suffers from a severe non-robustness:
  - Heterogeneity in claims to firm profits
- The reason is that profit income is countercyclical, which forms a negative income effect to a positive demand shocks

Intro 3: Heterogeneity

- To make the argument as clean as possible, we study a model with minimal heterogeneity:
  - Capitalists who own production technology
  - Laborers who own productive labor
  - Access to bond market under reasonably calibrated bond holding costs
- Comparing the WC model and the representative agent version of both labor market models reveals that
  - Competitive labor markets cannot generate any action in output to monetary shock when adding heterogeneity
  - Rigid labor market model is unaffected by adding heterogeneity

Intro 4: Consequences

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Intro 5: Related literature

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Models

- Presentation of the similarity and difference between the standard and WC model