

# The New Keynesian Transmission Channel

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# The Appeal of the New Keynesian Framework

- ▶ The New Keynesian model has been a success story
- ▶ It captures the notion of "aggregate demand", which has been an intuition of economist for many years but previously hard to reconcile with forward looking optimizing behaviour
- ▶ Contrary to the RBC, it can match, qualitatively and quantitatively, the VAR evidence on
  - ▶ the response on inflation and output to monetary shocks
  - ▶ the response of inflation and employment to productivity shocks

# Our contribution

- ▶ We investigate the textbook New Keynesian model (sticky prices, monopolistic production, labor is sole production factor)
- ▶ We show that transmission of any shock to employment and output hinges on profits being redistributed back to the household that supply labor
- ▶ In a model where all profit income goes to capitalists, a positive chock to
  - ▶ TFP  $\rightarrow$  Increasing output, constant employment
  - ▶ Interest rate  $\rightarrow$  Increasing inflation, constant employment and output
  - ▶ Government spending  $\rightarrow$  Increasing output and employment, but an order of magnitude less so than in the standard model

# Bibliography