



Research Working Papers

Attention Allocation and Heterogenous Consumption Responses

by: Yulei Luo, Jun Nie and Penghui Yin

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Differences in households' risk assessments help explain differences in households' consumption responses during the Great Recession.

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Recessions often have detrimental effects on both employment and equity prices, forcing individuals to make decisions about how to balance risks to their labor and capital income. In this paper, we study how individuals allocate their limited attention between capital income and labor income risks in a two-period consumption-saving model with recursive utility. Specifically, we examine how the optimal attention and consumption-saving decisions are influenced by individuals' attention capacity, wealth endowments, preferences for risk and time, and income risks. We show that our model is consistent with several novel facts regarding how differences in individuals' wealth levels and beliefs about their unemployment risks influenced their consumption during the Great Recession. Furthermore, we find that the welfare loss due to limited attention is significantly larger for households with lower wealth; allowing these households to flexibly allocate their attention can significantly reduce this welfare loss.

JEL classifications: C61, D83, E21

Article Citations

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Related Research

- Luo, Yulei, Jun Nie, and Eric R. Young. 2020. "Ambiguity, Low Risk-Free Rates, and Consumption Inequality." *Economic Journal*, vol. 130, no. 632, pp. 2649-2679. Available at <https://doi.org/10.1093/ej%2Fueaa045>

- Luo, Yulei, Jun Nie, Gaowang Wang, and Eric R Young. 2017. “Rational Inattention and the Dynamics of Consumption and Wealth in General Equilibrium.” *Journal of Economic Theory*, vol. 172, pp. 55-87. Available at <https://doi.org/10.1016/j.jet.2017.08.005>
 - Sims, Christopher A. 2003. “Implications of Rational Inattention.” *Journal of Monetary Economics*, vol. 50, no. 3, pp. 665-690. Available at [https://doi.org/10.1016/S0304-3932\(03\)00029-1](https://doi.org/10.1016/S0304-3932(03)00029-1)
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