Research Working Papers

Elastic Attention, Risk Sharing, and International Comovements

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December 30, 2015

How does rational inattention reduce cross-country consumption correlations?

RWP 15-16, December 2015

In this paper we examine the effects of elastic information-processing capacity (or optimal inattention) proposed in Sims (2010) on international consumption and income correlations in a tractable small open economy (SOE) model with exogenous income processes. We find that in the presence of capital mobility in financial markets, optimal inattention due to fixed information-processing cost lowers the international consumption correlations by generating heterogeneous consumption adjustments to income shocks across countries facing different macroeconomic uncertainty. In addition, we show that RI can also improve the model's predictions for the other key moments of the joint dynamics of consumption and income. Finally, we show that the main conclusions of our benchmark model do not change in an extension with capital accumulation.

JEL Classification: D83, E21, F41, G15

Article Citation

- Nie, Jun, Yasuo, Yulei Luo, and Wei Li. 2015. “Elastic Attention, Risk Sharing, and International Comovements,” Federal Reserve Bank of Kansas City, working paper no. 15-16, December. Available at https://doi.org/10.18651/RWP2015-16

Related Research

- Luo, Yulei, Jun Nie, and Eric R. Young. 2014. “Robust control, informational frictions, and international consumption correlations,” European Economic Review, 67, 1-27. Available at http://doi.org/10.1016/j.euroecorev.2013.12.007
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