

Macroeconomic Expectations and Cognitive Noise

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Abstract

Economic agents face a vast amount of information about the macroeconomy. In this paper, I study how expectations are formed when the capacity to process information is constrained. Compared to the prior literature, I suppose that such constraints apply to information both external and internal to the mind of forecasters. I show that jointly considering these two constraints is important. Qualitatively, the proposed model accounts for the seemingly puzzling patterns emphasized in the literature. Quantitatively, it reveals that the existing literature is likely underestimating the magnitude of information constraints. Finally, I emphasize that economic agents' expectations can vary with a change in economic policy. I show that the conduct of monetary policy affects inflation expectations and how firmly they are anchored.

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