

Imperfect Information and Inflation Dynamics

(with Fabrice Collard (Toulouse))

Abstract

The original version of the new Keynesian model has important empirical limitations, in particular with regard to inflation, output and interest rate dynamics. Some of its recent extensions fare better empirically but only by relying on implausible pricing schemes. We offer an alternative approach that emphasizes realistic information imperfections. The presence of a signal extraction problem gives rise to inflation persistence, realistic inflation and output dynamics and a liquidity effect.