

Elastic Attention, Risk Sharing, and International Comovements

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December 2015

Summary

In this paper we examine the effects of elastic information-processing capacity (or elastic attention) 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, elastic attention due to a fixed information-processing cost lowers international consumption correlations by generating heterogeneous consumption adjustments to income shocks across countries facing different macroeconomic uncertainty. In addition, we show that elastic attention can also improve the model's predictions for 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.