

Learning from prices*

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Abstract

Most DSGE models assume full information and model-consistent expectations. This paper takes the standard stochastic growth model with incomplete markets and heterogeneous agents and relaxes both these assumptions. Households are modelled as estimating processes for prices without knowledge of the aggregate states or the structure of the economy. Given households' perceived laws of motion, the actual law of motion is derived and conditions for e-stability given. Stability under OLS and constant gain learning is investigated and the economy is shown to converge from a wide range of priors. An econometrician might be unable to distinguish the economy under constant gain learning from one with model-consistent expectations.

JEL classification: D52; D84; E32.

Keywords: imperfect information; adaptive learning; dynamic general equilibrium; heterogeneity; expectations.

Preliminary and incomplete. Please do not cite or distribute.

Paper copies will be provided in the seminar. If you would like one earlier, please contact me.

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