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Belief Distortions and Endogenous Wage Rigidity in a Search Economy*

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Abstract

Household survey data contain a robust reversal of the Phillips-curve sign: consumers who expect higher unemployment also expect higher inflation, while professional forecasts and post-1980s U.S. data display the conventional negative relationship. Respondents in the Survey of Consumer Expectations who simultaneously expect higher inflation and higher unemployment also report higher personal job-loss risk, suggesting the distortion extends to perceived labor-market conditions. I embed this fact in a New Keynesian search-and-matching model with rational inattention, where workers with limited information capacity choose what to pay attention to. Supply-side risks receive more attention because they are costly on every margin; demand-driven improvements in the labor market are tracked less closely because higher prices partly offset a tighter job market. When a demand expansion improves workers' bargaining position, inattentive workers do not fully perceive the improvement and accept wages that are too low. The resulting wage rigidity is endogenous rather than imposed. At the quarterly structural calibration, the wage distortion after demand shocks is five times larger than after supply shocks, and this asymmetry is robust to the flow value of unemployment, supply-shock persistence, and the wage-belief elasticity.

JEL Codes: D83, E24, E31, E32, J64

Keywords: rational inattention, search and matching, belief distortions, Phillips curve, endogenous wage rigidity

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