

Print Edition

Thursday 15 October 2026

EDITION NO. 84 • 2 PIECES • 8 PAGES

IN THIS EDITION

- | | | |
|----|--|---|
| 1. | A Nobel for New Keynesian macro, at last! • Noahpinion | 1 |
| 2. | weekly link roundup (October 14, 2026) • Lauren Policy | 8 |
-

A Nobel for New Keynesian macro, at last!

BY NOAH SMITH • NOAHPINION • 13 OCTOBER 2026

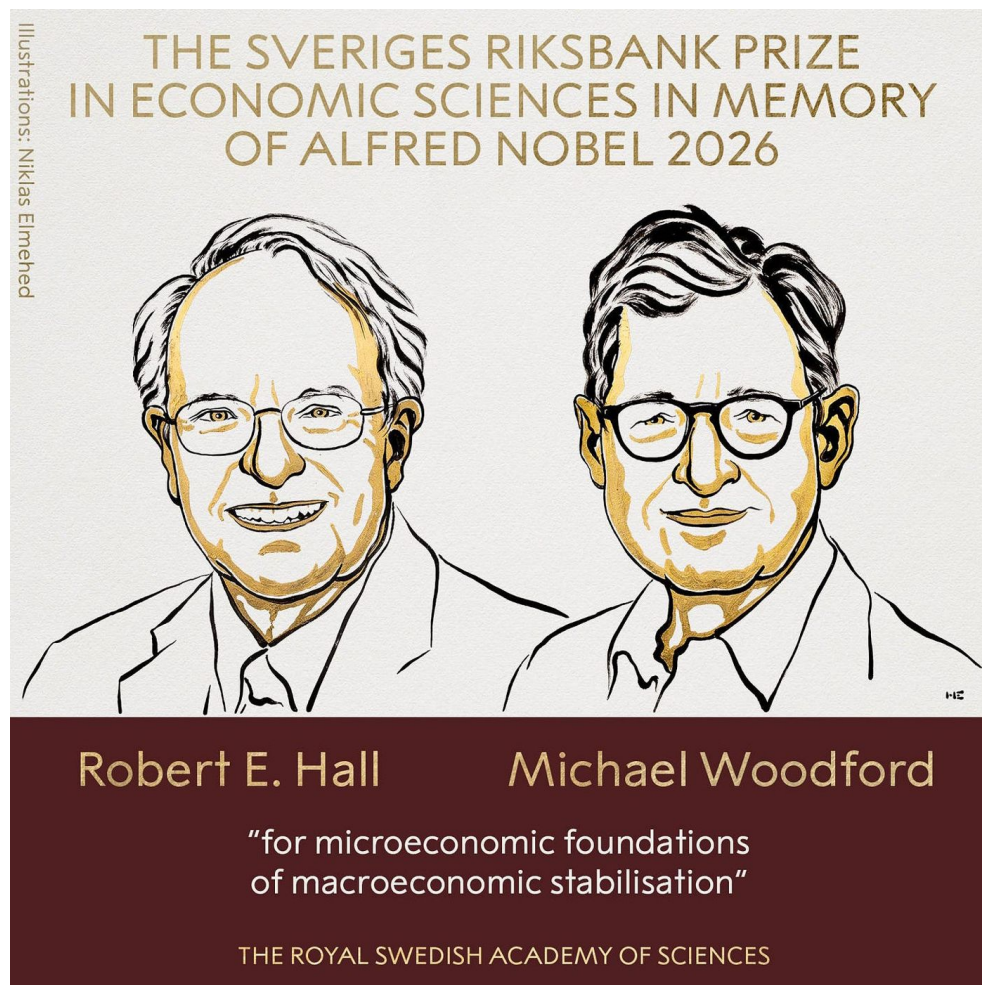


Image via The Nobel Prize

I have a Google Doc with a long list of posts I've been meaning to write. Far down the list was a line that read "New Keynesian macroeconomics deserves a Nobel". Somehow I never got around to writing that post, and now I never will. Because today, it happened! This year's Econ Nobel went to Bob Hall and Mike Woodford, two of the theory's most important creators.

First, let me say that this prize is long overdue. In 2009, I asked my PhD advisor, Miles Kimball, who was the greatest living macroeconomist. Without hesitation, he answered "Bob Hall", and said he would be very surprised if Hall didn't win the Nobel at some point. Hall's work is breathtakingly broad; if you want good summaries, I recommend Alex Tabarrok and Tyler Cowen (as usual). As for Michael Woodford, everyone I know assumed that if New Keynesian macro ever did get the prize, Woodford would be included, as he literally wrote the book on it.¹

But anyway, let's talk about New Keynesian economics — what it is, how it came about, why it's important, and why it didn't get a Nobel until now. Let's start with a brief history of modern macroeconomics.

Back in the 1960s and early 1970s, most economists tried to understand the macroeconomy by looking at relationships between macroeconomic aggregates. For example, "If income goes up by 10%, how much will spending go up?". Or "If inflation goes up by 3 percentage points, how much will unemployment go down?".²

The problem with that is that *correlation isn't causation*. Suppose you see that when inflation rises, unemployment goes down. That correlation is called a Phillips Curve. So you think "OK, if we raise inflation, more people will get jobs". But you try that, and it doesn't work — you push inflation up (by printing more money), but unemployment stays high. The correlation you saw before has now broken down. Now you've got two problems instead of one!

This is a very simplified version of what a lot of economists think happened in the 1970s. Whether that's what really happened is a story for another day. But the stagflation of the 1970s prompted the econ profession as a whole to rethink how it modeled the macroeconomy. A lot of researchers asked: What parts of the macroeconomy are *invariant* to policy? What are the solid foundations we can stand on, so that when we try to make some sort of change, we don't cause our own theories to crumble?

The answer most economists settled on was called "microfoundations". They reasoned that the basic drivers of *individual and corporate* economic behavior shouldn't change when macro policies like interest rates and government spending change. Most importantly, those drivers include:

1. Technology
2. Consumer preferences
3. The process by which people and businesses form **expectations** of the future

Do all three of these really stay the same when economic policy changes? Probably not completely. But it gave macroeconomists a place to start. So in the late 1970s and early 1980s, economists started to build

macro models based on theories of individual and corporate behavior. These were called “microfounded” macro models.

The last of those three “microfoundations” — expectations — was particularly thorny to think about. Almost any sort of expectation-formation process that you write down allows policymakers to trick people over and over, by surprising them systematically. Economists thought that eventually, people should wise up to the government’s tricks. So they came up with the idea that consumers and businesses should, on average, be as smart as the economists making the models. If economists write down a model of how the world works, that model should be the average person’s mental model in the model. Basically, people generally know how the economy works, and they plan accordingly.

This idea is called “rational expectations”.

In 1978, Bob Hall wrote a very influential paper that convinced a lot of economists that this was the right track. Hall wanted to test a simple idea, originally developed by Milton Friedman: If people plan out their consumption in advance, then changes in the level of consumption should be *completely random*.³ Nothing from last quarter should be able to predict the change in consumption this quarter — because if something last quarter mattered for this quarter’s consumption, people would *already have changed their consumption* last quarter! Hall found that, sure enough, a bunch of variables that seemed like they should be important for consumption — especially last quarter’s income — didn’t actually help predict changes in consumption.

For a more detailed explanation, I recommend this post by John Cochrane:



The Grumpy Economist
Bob Hall and Consumption
I wrote this essay on Bob Hall and Consumption (link goes to pdf on my webpage) for the conference in honor of Bob Hall at Hoover, November 22. It turned into a more extended history of some trends in macroeconomics, which any student of macroeconomics might find useful. Why we do what we do is often obscure. If this post exceeds your email limit, finis...
Read more
2 years ago
· 35 likes · 8 comments · John H. Cochrane

Brian Albrecht has a good (brief) explanation as well.

At first blush, this might not seem like an important result. After all, absence of evidence isn’t evidence of absence — there might be other variables that do predict changes in consumption, that Hall simply forgot to test. And in fact, Hall *did* find one variable that predicted future changes in consumption: stock prices. So even in the formal sense, the basic theory didn’t quite hold. Nor did Hall’s result rule out the traditional Keynesian idea of consumption — if government spending surprises people, it can move consumption immediately, without creating any sort of predictable future change.

But it was an important result, for two reasons. First, if people plan ahead when making their economic decisions, it should be possible for policymakers to influence today’s behavior by making promises about

what they'll do in the future. Second, if it's impossible for economists to predict changes in consumption, that implies that consumers are as good at planning their future consumption as economists are.

If that's true, it's an important lesson for policy: If you want to make people consume more, or if you want to make businesses hire more, etc., you have to do it in a way such that people generally understand what you're doing.

So macroeconomists set out to make models of the economy in which people understand how the economy works. At first, this effort didn't go well. For example, one very popular early idea — which eventually won a Nobel — was called “real business cycle” (RBC) theory. This was the idea that recessions and booms are driven purely by changes in the rate of technological progress — if engineers happen to invent less useful stuff this quarter, you get a recession.

No one denies that technological inventions can be very important for economic growth — just look at how the AI boom is powering the U.S. economy right now. But the idea that tech progress drives the business cycle in a simple, mechanical way just doesn't fit the evidence. In particular, productivity booms don't seem to line up with economic booms, as RBC theory would predict.⁴

Even more importantly, RBC models predict that monetary policy — raising and lowering interest rates — shouldn't affect the real economy. Ed Prescott, the creator of RBC theory, famously declared that monetary policy “is as effective in bringing prosperity as rain dancing is in bringing rain.” But our best evidence says that Prescott was wrong — monetary policy almost certainly does affect the real economy.

So something's going on there. Macroeconomists were missing something big — they didn't understand how or why monetary policy boosts growth and employment. During the 1990s, a bunch of economists started coming up with possible reasons why having the Fed buy bonds could result in more people getting jobs.

These ideas generally fell under the name of “New Keynesianism”. As John Cochrane and others have pointed out, this was something of a misnomer. Whereas John Maynard Keynes and his successors thought a lot about fiscal policy — i.e. government spending and taxes — the New Keynesians of the 1990s and 2000s focused almost entirely on monetary policy. New Keynesian macro initially owed a lot more to Milton Friedman than it did to Keynes — everything was about the Fed, and the idea of fiscal stimulus initially fell by the wayside.

Anyway, in the 90s and 2000s there were plenty of ideas about how monetary policy could affect the real economy. This is probably one big reason why New Keynesian economics was so slow to win a Nobel — it has so many creators that it's not even clear who deserves the prize. Greg Mankiw, David Romer, Stanley Fischer, George Akerlof, Janet Yellen, Olivier Blanchard, Nobuhiro Kiyotaki, Jordi Gali, Mark Gertler, John Taylor, Guillermo Calvo, and a bunch of others contributed pieces to the edifice.

Most of these contributions were ideas about why prices are slow to adjust to macroeconomic fluctuations. Basically, if you have something that

decreases aggregate demand — say the Fed raises interest rates like in 1980, or there's a banking panic after a housing bubble bursts like in 2008 — there's a question of why companies don't just cut prices and maintain the same level of output. If there's something causing prices to fall too slowly, that can force companies to produce less instead. A lot of New Keynesian theory is about why companies have difficulty cutting prices.

Bob Hall made very important contributions here too! The basic New Keynesian model explains how interest rates can affect GDP, but it doesn't explain why that affects *employment*. After all, if growth slows down, it's not immediately obvious why a bunch of people should be thrown out of their jobs. In a 2005 paper, Hall made a model explaining how wages might be slow to adjust to changes in demand — meaning that when there's a downturn, companies can't just cut wages, but instead have to lay off workers.⁵

Anyway, New Keynesian economics wasn't the brainchild of a few famous founders — it was a riot of new ideas. It needed someone to come synthesize all of those ideas into something simple that central bankers could use to set monetary policy in real life. That man was Mike Woodford.

In a paper with the late Julio Rotemberg, Woodford laid out a simple New Keynesian model. On the question of why companies have difficulty cutting prices in a recession, he punted — Woodford simply assumed that for whatever reason, only some companies are able to change their prices each quarter.⁶ (This idea is called “Calvo pricing”, after its creator, Guillermo Calvo.) The rest of the model is pretty simple. Woodford uses the same basic consumption-smoothing model from Hall's 1978 paper, in which people's decision of how much to consume and how much to save depends on the interest rate. He assumes that the central bank (i.e., the Fed) sets interest rates according to a simple rule that balances out the risks of inflation and unemployment. There are a few more assumptions in there, but those are the basics.

This simple model provides a guide for monetary policy. It explains how the central bank can cause a recession in the short term — like Paul Volcker did in the early 1980s, when he raised interest rates to fight inflation — but can't raise employment forever by keeping rates permanently low. And it explains how the central bank can respond to a drop in private demand — say, from a financial crisis like the one in 2008 — by cutting interest rates to stabilize the economy in the short term.

In other words, Woodford's model — which he later expanded into a famous book — is a *grand synthesis* of the general consensus that emerged from the intellectual ferment of macroeconomics from the 1970s through the 2000s. We knew that aggregate demand was a real thing. We knew that the economy had trouble adjusting to negative demand shocks, resulting in a lot of disruption — reduced output, people getting thrown out of work, and so on. And we knew that monetary policy could boost the economy in the short term, but that its effect probably faded in the long term. Woodford gave us the *simplest plausible model* to describe all of that, and to offer central banks a badly-needed road map for stabilizing the economy.

Because it was so simple and so applicable, Woodford's New Keynesian model became the standard tool of central banks around the world. No sooner was his synthesis complete, however, than it ran into a huge problem. In 2008 and 2009, the U.S. and European economies were hit by such a huge negative demand shock that cutting interest rates all the way to zero failed to put things right. Something else was needed.

There were three basic ideas for what that "something else" should be. The first is contained in Woodford's model, and draws on the basic idea in Hall's papers. It's the idea of "forward guidance". If the central bank can promise to leave interest rates low for a long time even after the recession is over, that can prompt consumers to spend more today — thus hastening the end of the recession.⁷ The second is quantitative easing — having the Fed buy long-term bonds instead of just short-term ones, in order to push down long-term interest rates. QE isn't in Woodford's model, but he eventually came around to supporting it.

The third idea was *fiscal stimulus*. If interest rates go all the way to zero, then government spending can become a more effective way of raising demand (as long as the central bank doesn't cancel out the stimulus by raising rates again). When the Great Recession hit, New Keynesian economists scrambled to put Keynes back into their theories, by adding a role for fiscal stimulus.

Hall wrote a paper in 2009 explaining how stimulus could be effective:⁸

[T]he multiplier linking government purchases to GDP may be in the range of 0.7 to 1.0...but higher values are not ruled out. New Keynesian macro models have multipliers in that range as well... Multipliers are higher—perhaps around 1.7—when the nominal interest rate is at its lower bound of zero, as it was during 2009.

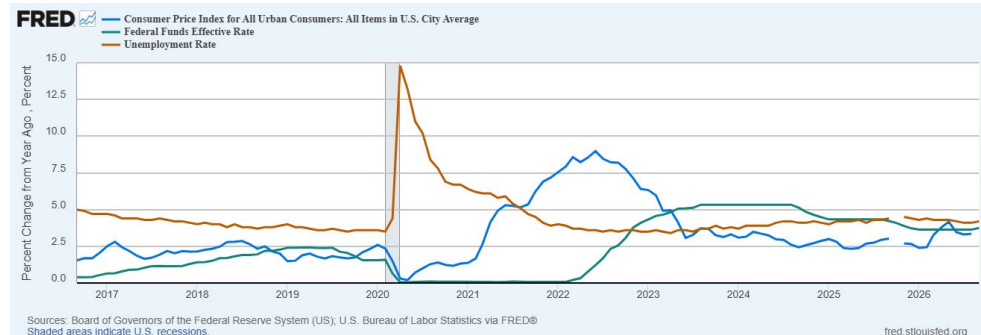
In that paper, Hall explains how fiscal stimulus can be effective even in light of his famous result from 1978. Even if there is no simple "consumption function" linking stimulus directly to spending, there are plenty of ways that stimulus can affect the behavior of companies and consumers, especially when interest rates are at zero.

And Woodford wrote a paper in 2011 showing how stimulus works in his basic model:

This paper explains the key factors that determine the output multiplier of government purchases in New Keynesian models, through a series of simple examples that can be solved analytically. Sticky prices or wages allow for larger multipliers than in a neoclassical model, though the size of the multiplier depends crucially on the monetary policy response. A multiplier well in excess of one is possible when monetary policy is constrained by the zero lower bound, and in this case welfare increases if government purchases expand to partially fill the output gap that arises from the inability to lower interest rates.

So in the end, the New Keynesians went beyond the ideas of Milton Friedman, and brought some Keynes back into their theories.

But New Keynesianism's biggest success arguably came not in the Great Recession, but in the post-pandemic inflation of 2021-23. Inflation spiked to 9% in 2022, but then came down to around 3% in early 2023 after the Fed raised interest rates. But what's remarkable is that unlike in the early 1980s, this happened without a big rise in unemployment!



It's not clear exactly why this happened, of course, but it sure looks like a big victory for the kind of New Keynesian macro that Bob Hall and Mike Woodford pioneered. The most likely explanation for this "immaculate disinflation" is that as soon as businesses realized that the Fed would do whatever it took to beat inflation, they stopped raising prices — and inflation simply ended.

It didn't require demand destruction like Volcker caused in the early 1980s. It didn't require legions of down-and-out unemployed blue-collar workers cutting back on essential purchases to finally force companies to stop raising their prices. All it required was a clear Fed commitment, and forward-looking expectations — exactly the mechanisms at the core of Bob Hall and Mike Woodford's models.

It was this episode, even more than 2008-9, that truly represented New Keynesianism's acid test. And it seems to have passed with flying colors. There was always a question mark hanging over the theory — it was always unclear whether it could shape the future instead of simply telling a story about the past. Since 2022-23, the answer to that question looks like a much more unambiguous "yes".

I wouldn't be surprised if that had something to do with this long-overdue Nobel.

1

Believe it or not, I have read that book cover to cover.

2

These are simple examples, but sometimes these models could get very big and complicated!

3

Except for a smooth trend, which people plan out in advance

4

Here's another good paper showing the same thing.

5

This was far from Hall's only contribution to New Keynesian macro. Another example is his 1986 paper showing how monopoly power could exacerbate economic booms and busts.

6

Woodford separately wrote down a model of how Calvo pricing might arise from imperfect information. It's not clear how important this model is, though, or whether Woodford — or anyone else — actually thinks that this is the real reason prices are slow to adjust.

7

Interestingly, it looks like we did this. The Fed kept interest rates ultra-low even in the late 2010s, when demand had recovered. And it even kept rates low in 2021 as inflation was surging. There's an interesting paper to be written there about how sluggishness in the Fed's reaction function might be a substitute for forward guidance, and act as an automatic stabilizer of sorts.

8

The “multiplier” here is a measure of the effectiveness of stimulus. When the multiplier is greater than one, it means a dollar of government spending raises GDP by more than a dollar.

weekly link roundup (October 14, 2026)

BY LAUREN GILBERT · LAUREN POLICY · 14 OCTOBER 2026

this week's list is being written at 35,000 ft while on a lot of cold medication. it may not be coherent.

- This week, hosts a Lant Rant.
- Anthropic is hiring social scientists to train Claude to be a better social scientist.
- New maps of remittance flows!
- Agents + banks with weak security = probably a bad combination.
- Nobel Prize-winning economists are surprisingly likely to have published in sociology journals (about 25% have).
- This is a very long list of ways women avoid harassment by men in India. It is bleak.
- Five times in the last 40 years, NSF polled Americans on whether they thought scientists were “odd and peculiar”. Weirdly, only about half said yes.