

## Human Frictions in the Transmission of Economic Policy

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### *Abstract*

Intertemporal substitution is at the heart of modern macroeconomics and finance as well as economic policymaking, but a large fraction of a representative population - those below the top of the distribution by cognitive abilities (IQ) - do not change their consumption propensities with their inflation expectations. Low-IQ men are also less than half as sensitive to interest-rate changes when making borrowing decisions. Low-IQ men account for more than 50% of the individuals and 50% of the labor income in our sample, which includes unique merged administrative data on cognitive abilities, economic expectations, and consumption and borrowing plans from Finland. Heterogeneity in education, income, other expectations, and financial constraints do not explain these results. Limited cognitive abilities are *human frictions* in the transmission and effectiveness of economic policy and inform research on heterogeneous agents in macroeconomics and finance.