

Inflation Persistence:
Micro Evidence and Policy Implications for EU New Members
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Non-technical Summary

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In this project, we focus on the behavior of prices and inflation using large micro level datasets from the Czech Republic and Slovakia. The first paper analyzes the experience of an emerging economy, Slovakia, using a large micro-level dataset that accounts for a substantial part of the consumer price index (about 5 million observations). We find that

- Market structure is an important determinant of pricing behavior.
- The effect of market structure on persistence of inflation results from two conflicting forces. Increased competition may reduce persistence by increasing the frequency of price changes. In contrast, higher competition may increase persistence through inertial behaviour induced by the strategic complementarity among price setters. In our case study, we find that the latter effects dominate.
- The frequency of price changes depends negatively on the price dispersion and positively on the product-specific inflation. These results seem consistent with predictions of Calvo's staggered price model.

The second paper provides an empirical analysis of inflation persistence in one of inflation targeting countries, the Czech Republic, using 412 detailed product-level consumer price indexes underlying the consumer basket over the period from 1994:M1 to 2005:M12. Subject to various sensitivity tests, our results suggest that

- Raw goods and non-durables, followed by services, display smaller inflation persistence than durables and processed goods.
- Inflation seems to be somewhat less persistent after the adoption of inflation targeting in 1998.
- There is evidence for aggregation bias, that is, aggregate inflation is found to be more persistent than the underlying detailed components.
- Price dispersion, as a proxy for the degree of competition, is found to be *negatively* related to inflation persistence, suggesting that competition is not conducive to reducing persistence.