

Non-technical summary

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Survey Evidence on Price Setting Patterns of Romanian Firms

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The paper looks at the beliefs of Romanian firms regarding the environment in which they operate, their price and wage setting behavior and the impact of potential adverse financial shocks on prices and costs.

Besides their significance for the overall functioning of the economy, various features of firms' behavior (e.g. duration of price quotation, theories explaining price stickiness, degree of competition faced) are important variables to be considered when incorporated in different models trying to explain the short term impact monetary policy has on the real sector.

The methodology employed is similar with that carried out by the "European Inflation Persistence Network" (IPN) studies that surveyed firms to investigate similar aspects. While covering most two-digit NACE sectors, the interpretation of results should take into account the relatively low answer rate and the inherent uncertainty regarding survey data.

The findings indicate that:

- ❖ Romanian firms perceive the environment they operate in as more competitive than the firms surveyed in the IPN project. This is mainly due, on the one hand, to small firms having a more prominent role in our sample and, on the other hand, to those same firms facing more fierce competition when compared to large firms, as opposed to the situation reflected in the IPN surveys, where large firms display a more competition-constrained behavior.
- ❖ Most of the firms claim to have full autonomy in setting the price. Among these, around half use the market price as the main pricing rule, with a slightly lower share of firms setting the price as a mark-up over costs. These results are due to the predominance of market price adoption by small firms, while medium and large firms use mostly mark-up pricing, which is consistent with the degree of competition they perceive.

- ❖ The large majority of firms use a combination of backward and forward-looking information when reviewing prices. Around 60% of firms use either a time-dependent pricing rule or one that incorporates both time-dependent and state-dependent elements. Pure state-dependent pricing is dominant only in the case of small firms.
- ❖ Romanian firms revised and changed their prices in 2005 much more frequently than what the reports summarized in Fabiani et al. (2005) suggest is usually the case for euro zone firms. Conditional on following a time and mixed-dependent pricing rule, Romanian prices were revised almost quarterly, the average duration being around 5 months. Large firms revised and changed their price much more often than the medium and small ones, probably due to more significant costs of mis-pricing their products and lower costs of price optimization.
- ❖ Costs of raw materials in the case of price increases and competitors' price, raw materials costs and demand changes in case of price decreases are the main factors determining price changes. When it comes to the main causes of price stickiness (although when observed this is relatively low), implicit and explicit contracts rank first. This is broadly similar with the rankings obtained for EMU countries.
- ❖ Wages are stickier than prices. Around 72% of firms change their wages once per year or less often, the most important factor leading to wage variations being the change in productivity.
- ❖ Firms usually fully transmit into their prices the full impact of strong unanticipated financial shocks. Strong variations of the exchange rate are typically perceived more strongly than interest rate shocks.

At this stage, additional analysis should be carried on in at least two directions: augmenting the current analysis with detailed balance sheet, foreign trade and bank exposure data and using the complementary approach carried out also under the "European Inflation Persistence Network" by investigating the micro data used for CPI compilation.