Small and Large Price Changes and the Propagation of Monetary Shocks
by Alvarez, Le Bihan and Lippi (ALL)

Discussion by
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The Paper

Documents

• Small and large changes in individual prices
• The size distribution of price changes displays positive excess kurtosis.

Formulates a general model

• Nests canonical models of price adjustment
  • Multiproduct firms and random menu costs on firms’ products
• Predicts the effectiveness of monetary policy depends on 1) $\varepsilon$, 2) kurtosis, and 3) frequency of price adjustment
Great paper!

• Sufficient statistic is novel in this literature—and extremely useful!
  – Models in the literature often opaque and cumbersome

• Bridges gap between empirical and theoretical work
  – Empirical work focused on frequency of adjustment.
  – ALL show kurtosis at least as important

• Admirable thoroughness (appendixes A to S)
  – Any question a reader might have is already answered!
Great paper! (cont.d)

• Thoroughness and generality makes the job of a discussant impossible!
  – Perfect paper in the literature

• So...I will discuss the literature
What if we introduce durables in the model?

• Flexibility of Durables is all that matters for the effectiveness of monetary policy
  – Barsky et al (AER 2007), largely neglected in the literature

• Prediction of model with durables counterfactual
  – In data: durables’ prices are fairly flexible (Klenow and Malin and others)
  – In model: following an expansionary monetary intervention, if durables’ prices are more flexible, prices of durables increase. Leads to a contraction in durables
  – Counterfactual:
    • Monetary policy is expansionary
    • Response of GDP is driven entirely by durables, whereas nondurables and services show no response
Durables in a NK model (cont.d)

• To rescue the NK model, need wage rigidity
  – Together with big adjustment costs!

• Why so much work on the analysis of micro data on price adjustment, then?
  – We should be looking only at wages
  – If prices, only durable goods’
  – Conclusion also stems from other fully-fledged models.
    • I.e., in Christiano, Eichenbaum and Evans (JPE 2005), all that matters for the effectiveness of monetary policy is wage rigidity; price rigidity plays a tiny quantitative role--- if any.
Back to ALL

• Model could be reformulated for wage rather than price adjustments

• Same for empirical work: indeed, there is evidence that firms adjust all wages at once (Olivei and Tenreyro, 2007---survey evidence):
  • US firms revise wages once a year, typically in Q4---changes implemented in Jan 1. (Timing of optimization decision versus timing of actual change maybe important!)
  • Timing of wage adjustments due to ‘fiscal year end’.
  • Effectiveness of monetary policy is seasonal—consistent with seasonality in frequency
  • Bunching of wage adjustment consistent with a ALL’s idea of a (fixed) menu cost that applies to all workers.
Implications for policy makers

• Can central bankers use the simple sufficient stat to predict the effectiveness of their intervention?
  – Not yet! (Even if Barsky et al. were not a concern)
  – In a more complex model with more general cost shocks, adjustment costs, financial frictions, etc., there will be other variables involved.
  • For trade guys life is easier, because they ignore all adjustment costs and any transition—ss analysis; here, short term adjustment is critical

• Still ALL succeed in providing a simple sufficient statistic to compare across a class of models
  – Insightful academic (and pedagogic) contribution!
Summary

• High academic value added!

• Not ready for policy implementation – but opening a new and promising way, which may (should) reset the standards in the literature

• Literature needs to think harder about durables – empirical focus should be on the adjustment of durable’s prices---and wages!