MONETARY SHOCKS IN MODELS WITH OBSERVATION AND MENU COSTS

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Abstract
We study economies where price stickiness arises due to the simultaneous presence of both menu and information costs. We identify the relative importance of these costs using firm’s survey data and analyze the response of prices and output following a permanent unexpected monetary shock. For a given frequency of price adjustment, we find that the information friction significantly amplifies the real effect of the shock when the shock is small, or when it is not known by firms. Instead, when the shock is large and known to firms the flexibility of prices increases and the real effects gradually vanish. (JEL: E23, E31, E52)

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