SERVICES DEEPENING AND THE TRANSMISSION OF MONETARY POLICY

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Abstract
The structural transformation from manufacturing to services comes with a process of services deepening: the services share of intermediate inputs rises over time. Moreover, inflation reacts less to monetary policy shocks in countries which are more intensive in services intermediates. We rationalize these facts using a two-sector New Keynesian model where trends in sectoral productivities generate endogenous variations in the Input-Output matrix. Services deepening reduces the contemporaneous response of inflation to monetary policy shocks through a marginal cost channel. Since services prices are stickier than manufacturing prices, the rise of services intermediates raises the sluggishness of sectoral marginal costs and inflation rates. (JEL: E31, E43, E52, O41)

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