

Integrating Sticky Prices and Sticky Information *

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Abstract

Understanding the relationship between nominal and real variables, most notably inflation and cyclical output, is one of economics' fundamental questions. Towards this understanding, we develop a model that integrates sticky information and sticky prices, i.e. dual stickiness. We find that both rigidities are present in U.S. data. We also show that the dual stickiness model's closest competitor is the hybrid New Keynesian model. For both models, current inflation depends in part on last period's inflation. The former model achieves this dependence endogenously through the interaction of the two rigidities, rather than through backward-looking behavior. U.S. data supports the dual stickiness over the hybrid model because lagged expectations terms appear in the former's inflation Euler equation. Finally, we show that it is important quantitatively to distinguish between the two by simulating a dynamic equilibrium model under each of the two inflation equations.

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