

Menu Costs at Work:

Restaurant Prices and the Introduction of the Euro
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The Euro Changeover

- 12 EU countries adopted the Euro January 2002
- Caused no significant CPI shock
- Significant sector-specific inflation shock
 - Cafes, restaurants, hairdressers, cinema, dry cleaners
 - Cash intensive sectors
 - Stickiest prices

Overall Inflation vs. Food Sector

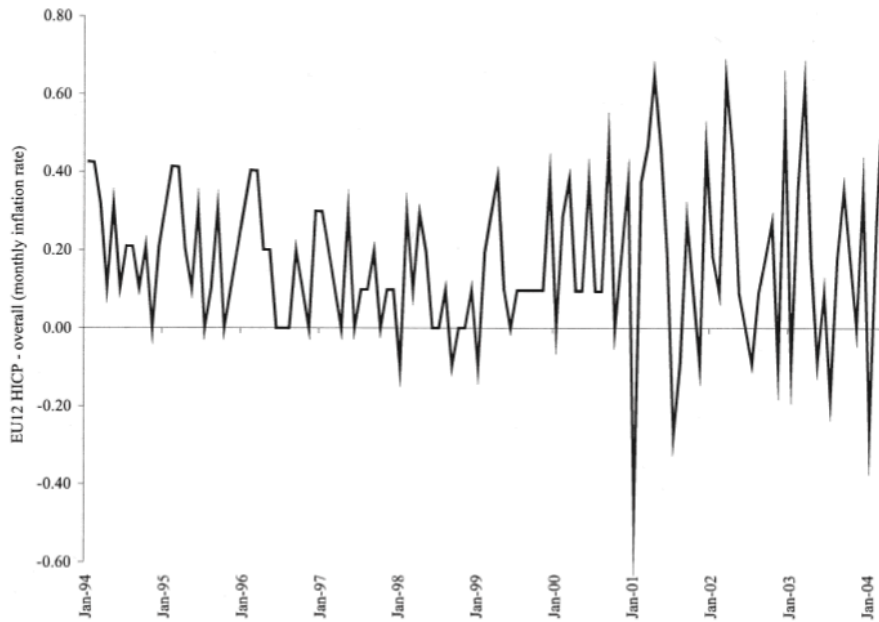


FIGURE I
EU12 Overall Inflation

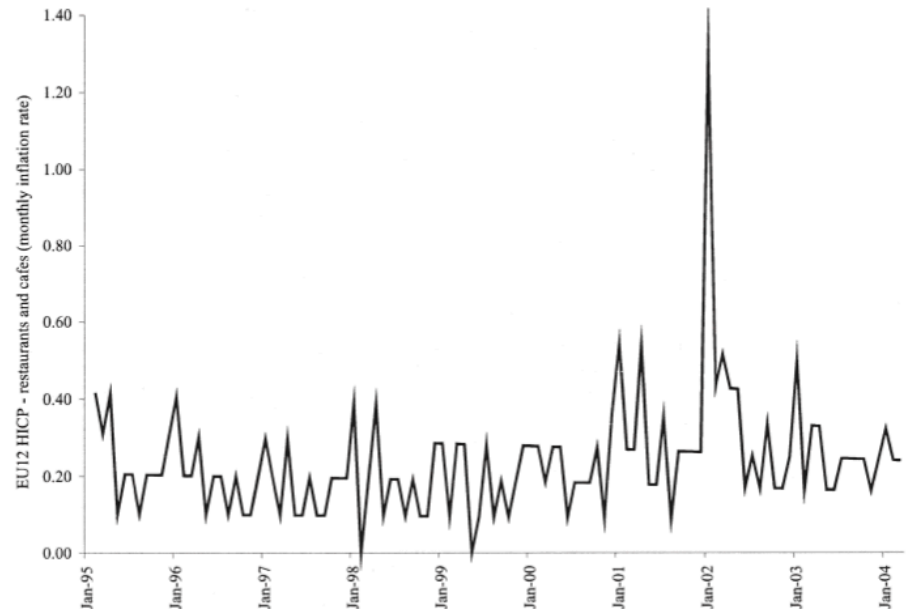


FIGURE II
EU12 Restaurant and Cafe Inflation

TABLE I
EU15 RESTAURANT AND CAFE INFLATION IN JANUARY 2002

Country	$\pi_{Jan2002}$	Mean ($\bar{\pi}$)	Std. dev. (s)	$(\pi_{Jan2002} - \bar{\pi})/s$	$(\bar{\pi}_{Jan} - \bar{\pi})/s$
Austria	0.5	0.2	0.2	2.0	0.8
Belgium	0.5	0.2	0.2	1.7	-0.1
Finland	2.0	0.2	0.3	5.6	1.0
France	1.4	0.2	0.2	8.1	1.5
Germany	2.1	0.1	0.2	9.0	0.8
Greece	0.3	0.5	2.1	-0.1	0.1
Ireland	1.2	0.4	0.4	2.0	0.5
Italy	0.8	0.3	0.2	3.3	0.4
Luxembourg	1.3	0.2	0.2	4.7	1.1
Netherlands	3.4	0.3	0.4	7.4	1.8
Portugal	1.4	0.3	0.4	2.8	1.0
Spain	1.2	0.3	0.2	3.7	2.4
EU12	1.3	0.2	0.2	6.9	1.7
Denmark	0.1	0.2	0.2	-0.4	0.3
Sweden	0.2	0.2	0.3	0.0	-0.2
Britain	0.1	0.3	0.1	-1.3	-0.6

The Model

- General pricing model
 - Small sector
 - Monopolistic competition
 - Menu costs
 - Real rigidity
- The four variants:
 - i. Calvo [1983] $\alpha \approx 13\%$
 - ii. Hybrid Calvo and Taylor [1980]
 - iii. Dotsey, King, and Wolman (DKW) [1999]
 - iii. Augmented DKW model with endogenous timing

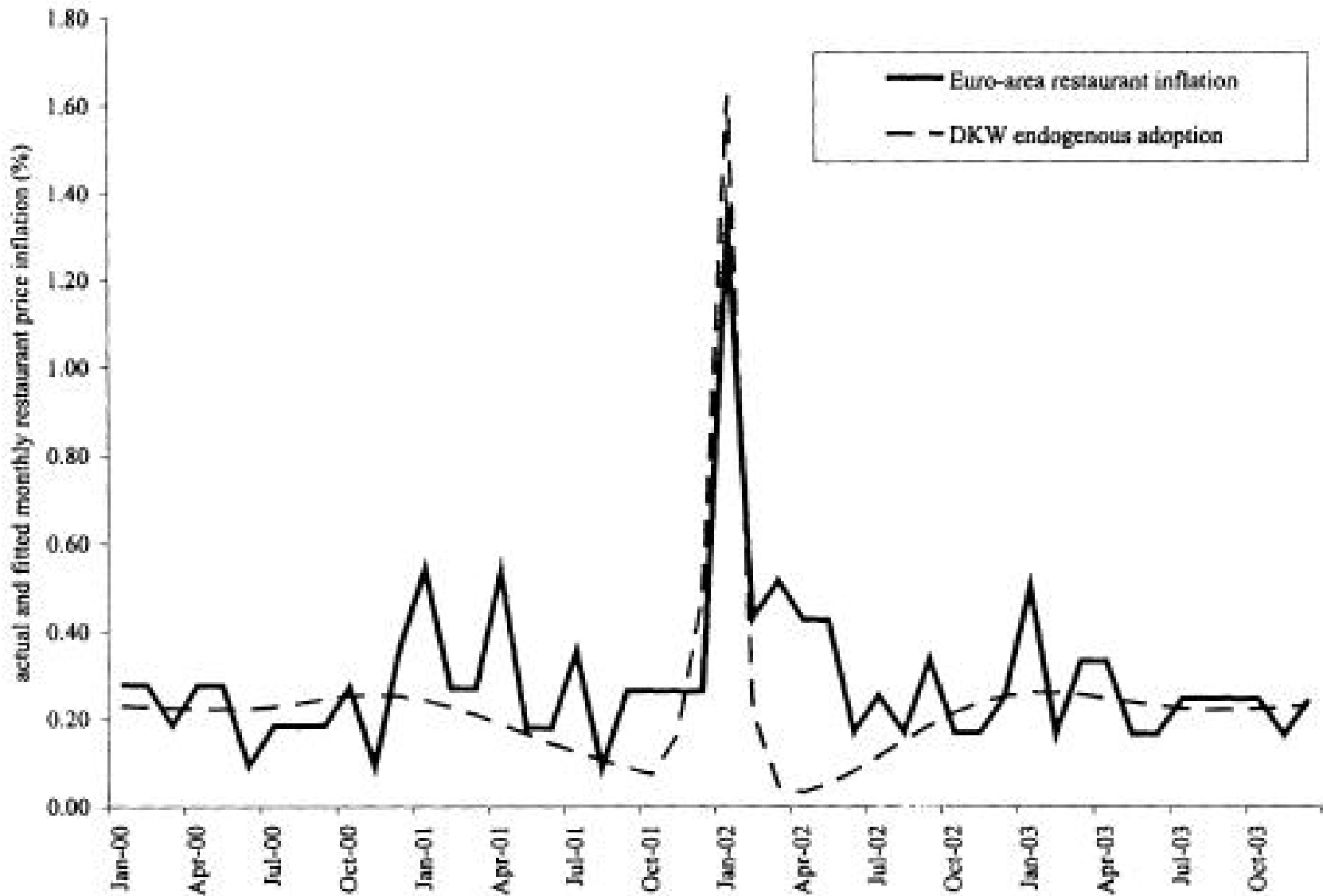


FIGURE VI
 Augmented DKW Model with Endogenous Adoption of the Euro

Conclusion

- Sticky sector Euro changeover inflation shock explained by menu costs model with endogenous timing
- Testable implications for currency changeover:
 - Price duration \sim Inflation shock
 - Decline in inflation before/after shock
 - No long run effects on relative prices