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Inventories and real rigidities in New Keynesian business cycle models ☆

Oleksiy Kryvtsov [a,*], Virgiliu Midrigan [b]

[a] Bank of Canada, Canada
[b] Department of Economics, New York University, 19 W. 4th St, 6th Floor, New York, NY 10012, USA

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Kryvtsov and Midrigan (2008) study the behavior of inventories in an economy with menu costs, fixed ordering costs and the possibility of stockouts. This paper extends their analysis to a richer setting that is capable of more closely accounting for the dynamics of the US business cycle. We find that the original conclusion survives in this setting: namely, the model requires an elasticity of real marginal cost to output approximately equal to the inverse intertemporal elasticity of substitution in consumption in order to account for the countercyclicality of the aggregate inventory-to-sales ratio in the data. *J. Japanese Int. Economies* **24** (2) (2010) 259–281. Bank of Canada, Canada; New York University, USA.

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1. Introduction

Real rigidities are factors that dampen the responsiveness of a firm's desired price to a monetary disturbance. Recent work with New Keynesian sticky price models[1] has argued that real rigidites are a key ingredient necessary to reconcile the apparently slow response of prices to nominal disturbances

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* Corresponding author. Address: Bank of Canada, 234 Wellington Street, Ottawa, Ontario, Canada K1A 0G9. Fax: +1 613 7827163.

E-mail address: okryvtsov@bankofcanada.ca (O. Kryvtsov).

[1] Christiano et al. (2005) and Smets and Wouters (2007) are two well-known examples.

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