

WHY SO SLUGGISH? ANALYZING THE DETERMINANTS OF PRICE ADJUSTMENTS IN THE SERVICE SECTOR USING SURVEY MICRODATA

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Understanding the determinants of inflation, especially services, is essential for the management of monetary policy. In addition to having a significant weight in the Brazilian Consumer Price Index (IPCA) - with approximately 35% in the average between 2008 and 2016, annual service inflation was consistently above the target ceiling between June 2008 and December 2016. Thus, good monetary policy management in the inflation target environment must ensure that service inflation remains consistently within the target tolerance range.

In this context, the purpose of the article is to understand the determinants of price readjustment of companies that operate in the service sector from the firm's point of view. To do this, we use the microdata from the rich monthly database of the Services Survey conducted by the Brazilian Institute of Economics of the Getulio Vargas Foundation. This database contains high-frequency information on the firm's assessment of economic conditions, such as demand, general business situation, and assessment of factors that may be limiting the company's performance, such as lack of skilled labor, financial costs, excessive competition in the sector, lack of space and equipment, etc.

In the article, we show that prices in the service sector are sluggish because the response of firms to changes in economic conditions is highly asymmetric. For example, when firms estimate that revenue will fall in the next 03 months, the probability of maintaining the price increases by 11% while the likelihood

of price reduction increases by 6.1%. On the other hand, when companies estimate that current demand conditions are worse, the probability of maintaining the price increases by 3.2% while the probability of price reduction is only 0.9%.

Among the limiting factors that have the capacity to raise prices, the most important is the lack of skilled labor. On average, firms reporting problems finding labor are 3% more likely to raise the price than other firms. Lack of space or equipment also positively affect the likelihood of price increases, but by 2%. The financial costs were not significant for the decision of the service companies when deciding on price readjustment. On the other hand, among the factors that reduce the likelihood of price readjustment, the most important is the lack of demand that decreases the probability of price increases by 6% and financial problems by 3%.

Business valuations of economic conditions also affect their decision to readjust their prices. However, in this block of variables, we conclude that for service sector firms the prospective assessment of revenue, demand, and other economic conditions are more important than the current or past assessment of these variables. This result suggests that firms in the service sector are more "forward-looking" than are reactive to costs or other current conditions. For example, worse valuation of current demand conditions reduces the likelihood of price increases by 4% while worse demand assessment in the next 03 months reduces the likelihood of price increases by 14%.

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Finally, the framework developed in the article is able to provide evidence that both the models of price readjustment depending on the economic variables and the time elapsed since the last readjustment are important to understand the behavior of the firm. One month after price readjustment, companies are 35% less likely to readjust prices while this level remains at 2% 3 to 6 months after the readjustment and starts to rise. Approximately one year after the adjustment, the probability of a change in price is 16%.

In this paper, we offer evidence that behavior in the service sector is highly asymmetric in response to changes in economic variables. In this way, monetary policy management must pay special attention so upwards adjustments in the inflationary process of the services sector should be combatted, because there will hardly be any downward adjustments in the price. Thus, the inflation in this sector takes time to respond on changes in the economic environment. In addition, a better or worse outlook on future economic conditions proved more important than the current conditions. The management of expectations is fundamental for the determination of prices in this sector.

SUMÁRIO EXECUTIVO