

A Reinvestigation of the Markup and the Business Cycle

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Abstract

A fresh interpretation is provided of the influential finding that the markup of prices over marginal costs is counter-cyclical. Using Rotemberg and Woodford's (1991) data set we argue that the markup is best modelled as a variable that is integrated of order one. A consequence of this finding is that the markup cannot be related in the long run with business-cycle variables since these are traditionally thought of as being stationary. A distinction must therefore be made between the long- and the short-run behaviour of the markup. It is shown that the markup is negatively related to inflation in the long-run, while stationary transforms of the markup are counter-cyclical in the short-run.

Keywords: Inflation, Prices, Markup, Productivity, Business Cycles, Cointegration.

JEL Classification: C22, C32, C52, D40, E31, E32