

Abstract

We study the implications of rational inattention for individual price dynamics. Analyzing scanner data that cover 29 product categories over a eight-year period from a large Mid-western supermarket chain, we uncover a surprising regularity in the data—small price increases occur more frequently than small price decreases. We find that this asymmetry holds for price changes of up to about 15–30 cents (in absolute terms) and 3–10 percent (in relative terms). The asymmetry disappears for larger price changes. We document this finding for the entire data set, as well as for individual product categories considered. Moreover, we find that the asymmetry holds even when we exclude from the data the observations pertaining to inflationary periods. Given the inability of the existing theories to explain the particular form of asymmetry we document, we offer a new theory of asymmetric price adjustment, which can explain our findings. The theory, which is an extension of the literature on “rational inattention,” argues that observing, processing, and reacting to price change information is not a costless activity. An important implication of rational inattention is that consumers may rationally choose to ignore—and thus not to respond to—small price changes, creating a “range of inattention” along the demand curve. This range of consumer inattention, we argue, gives the retailers incentive for asymmetric price adjustment “in the small.” These incentives, however, disappear for large price changes, because large price changes are noticed by consumers and therefore trigger their response. Thus, no asymmetry is observed “in the large.”