

# Accepted Manuscript

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PII: S0022-1996(17)30156-3  
DOI: doi:[10.1016/j.jinteco.2017.12.006](https://doi.org/10.1016/j.jinteco.2017.12.006)  
Reference: INEC 3103

To appear in: *Journal of International Economics*

Received date: 22 August 2017  
Revised date: 15 December 2017  
Accepted date: 20 December 2017



Please cite this article as: Jarociński, Marek, Maćkowiak, Bartosz, Monetary-Fiscal Interactions and the Euro Area's Malaise, *Journal of International Economics* (2017), doi:[10.1016/j.jinteco.2017.12.006](https://doi.org/10.1016/j.jinteco.2017.12.006)

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## Monetary-Fiscal Interactions and the Euro Area's Malaise\*

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This version: December 2017. Initial version: May 2015.

**Abstract**

When monetary and fiscal policy are conducted as in the euro area, output, inflation, and government bond default premia are indeterminate according to a standard sticky-price general equilibrium model extended to include defaultable public debt. With sunspots, the model mimics the recent euro area data. We specify an alternative configuration of monetary and fiscal policy, with a non-defaultable eurobond. If this policy arrangement had been in place since the onset of the Great Recession, output could have been much higher than in the data with inflation in line with the ECB's objective. (*Keywords:* zero lower bound, fiscal theory of the price level, self-fulfilling expectations, eurobond. *JEL:* E31, E32, E63.)

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