Accepted Manuscript

International monetary equilibrium with default

M. Udara Peiris, Dimitrios P. Tsomocos

PII: S0304-4068(14)00145-1
DOI: http://dx.doi.org/10.1016/j.jmateco.2014.11.003
Reference: MATECO 1939

To appear in: *Journal of Mathematical Economics*

Received date: 14 September 2012
Revised date: 14 September 2014
Accepted date: 23 November 2014

Please cite this article as: Udara Peiris, M., Tsomocos, D.P., International monetary equilibrium with default. *Journal of Mathematical Economics* (2014), http://dx.doi.org/10.1016/j.jmateco.2014.11.003

International Monetary Equilibrium with Default*

M. Udara Peiris
ICEF, NRU Higher School of Economics, Moscow.

Dimitrios P. Tsomocos
Saïd Business School and St. Edmund Hall, Oxford.

September 14, 2014

Abstract

We present an integrated framework for the study of the international financial economy with trade, fiat money, monetary and fiscal policy, endogenous default and regulation. Money is introduced via a cash-in-advance requirement and real trade is endogenous. The standard international finance pricing results obtain. Market incompleteness and positive default in equilibrium allow for the study of the transmission of default through the international financial markets and imply a positive role for policy. Finally, we present an example where, due to the trade-off between the non-pecuniary cost of default and the resulting allocation, a Pareto improvement occurs following an increase in interest rates.

*Acknowledgements: Raphael Espinoza, John Geanakoplos, Charles Goodhart, Matthew Hoelle, Dmitry Levando, Li Lin, Juan Francisco Martinez, Ken Okamura, Han Oszoylev, Herakles Polemarchakis, Alexandros Vardoulakis, seminar participants at Warwick CRETA workshop April 2009, participants at 5th Annual CARESS-Cowles conference April 2009, participants at the 2009 European Workshop in General Equilibrium Theory, participants at the Infiniti 2009 conference on International Finance Dublin, participants at the IX SAET Conference in Ischia, and especially two anonymous referees and Alessandro Citanna. The first version of this paper appeared in January 2007. Corresponding author: upeiris@hse.ru. This paper constituted part of the PhD thesis of Peiris in Oxford, and work on it continued during his time at the Department of Economics, University of Warwick.