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Marek Jarociński, Bartosz Maćkowiak

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

Marek Jarociński

Bartosz Maćkowiak

European Central Bank

European Central Bank and CEPR

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**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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\*Jarociński: European Central Bank, 60640 Frankfurt, Germany (e-mail: marek.jarocinski@ecb.int); Maćkowiak: European Central Bank, 60640 Frankfurt, Germany (e-mail: bartosz.mackowiak@ecb.int). We thank for helpful comments Jordi Galí and Pierre-Olivier Gourinchas, our discussants at the NBER International Seminar on Macroeconomics, and Charles Engel (the editor). We are also grateful to Francesco Bianchi, Giancarlo Corsetti, Jean-Pierre Danthine, Luca Dedola, Christophe Kamps, Robert Kollmann, Eric Leeper, Karel Mertens, Hélène Rey, Sebastian Schmidt, Stephanie Schmitt-Grohé, Harald Uhlig, Michael Woodford, Xuan Zhou, and numerous conference and seminar participants. The views expressed in this paper are solely those of the authors and do not necessarily reflect the views of the European Central Bank.

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