



Banc Ceannais na hÉireann
Central Bank of Ireland

Eurosystem

On the risk of leaving the Euro

Discussion
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Madrid, 7 June 2016

Not only micro benefits?

- Analyzes structural change
- Optimum currency areas highlight
 - Micro economic benefits
 - Macro economic costs (exchange rate, monetary policy)
- This paper, in a moment of skepticism, highlights Macro benefit of Euro
 - Contingent reason, fiscal stress
 - Structural reason, learning

Not only macro benefits?

- Unpleasant monetaristic arithmetic

$$(M_t - M_{t-1}) + (B_t - B_{t-1}) = d_t P_t$$

- When crisis comes,
 - Bond financing is impossible
 - Temptation is monetary financing
 - This implies high, persistent inflation, potentially explosive path

Do not exit during a crisis!

- Money and inflation are depending on the deficit
 - High levels of deficit can lead to high inflation on bad side of Laffer curve
 - Persistence and level of inflation are fiscal determined
 - There's nothing to do about it

Do not exit during a crisis!

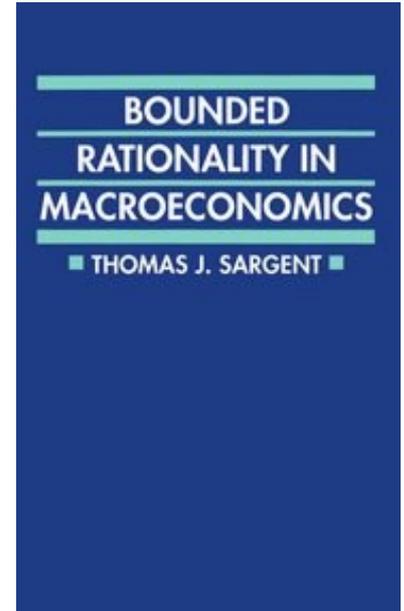
- What after exiting currency union?
 - Finance deficits with money, accept high, persistent (hyper)inflation
 - Peg exchange rate, not much additional leeway

Learning makes things worse

- Learning adds complexity
- Equilibrium was easy to learn under RE
- Now agents are assumed to use Kalman filter
- RE substantially insured stability
- Learning does not!

Learning, does it matter?

- Bounded rationality: too much freedom, non consistent with model, non endogenous.
- RE also slightly abused when structural changes are introduced
- Here, slight deviation from RE keeps discipline but allows for endogenous expectations
- Forward guidance, low inflation, imperfect credibility of CB, liquidity trap issues can be with



Models for policy makers

- Complex economy. An economic system is composed of
 - heterogeneous actors,
 - with different characteristics, expectations and behavioral rules
 - they interact with each other and with the environment.
 - actors are in constant adaptive learning, generating evolutionary systems. Internal rationality.
- Classic view (simplified) assumes
 - market clearing
 - perfect foresight /RE,
 - equilibrium behavior
- MCM-like models, GA, models of local interactions

Smaller comments for a paper

- Seignorage and deficit
 - Distinguish in notation persistence of deficit and of inflation
 - The structural reform, exogenous, seems to provide stability but
 - Where does it come from
 - And is it a substitute for exiting Euro?
- What happens in your simulations when exploding paths are detected?

Thank you very much!

