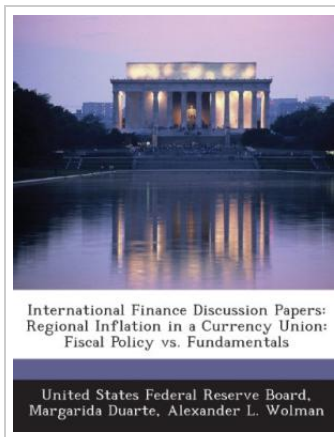



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International Finance Discussion Papers: Regional Inflation in a Currency Union: Fiscal Policy vs. Fundamentals

By Margarida Duarte, Alexander L Wolman

Bibliogov, United States, 2013. Paperback. Book Condition: New. 246 x 189 mm. Language: English . Brand New Book ***** Print on Demand *****.We develop a general equilibrium model of a two-region currency union. There are two types of goods: non-trade goods, and traded goods for which markets are segmented. Monetary policy is set by a central monetary authority and is non-neutral due to nominal price rigidities. Fiscal policy is determined at the regional level by each region's government. We find that productivity shocks alone generate significant variation in inflation across the two countries. Government spending shocks, in contrast, do not account for a significant portion of inflation variation. Varying relative country size, we find that smaller countries experience higher variability of their inflation differential in response to shocks to productivity growth. Moreover, we show that regional governments can suppress incipient inflation differentials associated with shocks to productivity growth by letting the income tax rate respond negatively to inflation differentials.


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