Monetary Policy and Sunspot Fluctuation
in the U.S. and the Euro Area[*]

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Abstract

We estimate a two-country open economy version of the New Keynesian model for the U.S. and the Euro area, using Bayesian techniques that allow for both determinacy and indeterminacy of the equilibrium. Our empirical analysis shows that the worldwide equilibrium is indeterminate due to a passive monetary policy in the Euro area even if the U.S. policy is aggressive enough. We demonstrate that the impulse responses under indeterminacy exhibit different dynamics from those under determinacy, and that the sunspot shocks affect the Euro economy in substantial degree while the propagation of sunspots to the U.S. is limited. (97 words)

Keywords:	Monetary Policy, Indeterminacy, Sunspot Shock,
	Open Economy Model, Bayesian Analysis
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