



Leibniz-Institut für
Wirtschaftsforschung Halle

IWH Research Seminar in Economics

Montag, 8. Mai 2017, 14:15 – 15:45 Uhr, Konferenzsaal im Erdgeschoss



The Worst of All Worlds: Exchange Rate Adjustment in the Euro Crisis

Professor Dr. Gernot J. Müller, Eberhard Karls Universität Tübingen

(zusammen mit Prof. Dr. Alexander Kriwoluzky Martin-Luther-Unviersität Halle-Wittenberg und IWH;
Martin Wolf, Ph.D., Universität Bonn)

Economic performance in the euro area has been heterogeneous during the recent decade. Still, intra-euro area real exchange rates have adjusted only slowly. In this paper, we first document that the half-life of intra-euro area real exchange rates has increased strongly after 2008. Second, we interpret this evidence through the lens of small open economy model which captures the key features of the crisis countries of the euro area: real exchange rates are misaligned, public debt is high, and there is uncertainty regarding euro membership of those countries in the future. We show that as these features interact, the half-life of the real exchange rate increases and macroeconomic adjustment slows down. Imperfect credibility as regards currency union membership entails i) a lack of flexibility common to fixed exchange rate regimes, as well as ii) a lack of discipline common to flexible exchange rate regimes—it brings about the worst of both worlds.

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