

## Abstract

This paper develops and estimates a dynamic stochastic general equilibrium (DSGE) model with sticky prices and wages for the euro area. The model incorporates various other features such as habit formation, costs of adjustment in capital accumulation and variable capacity utilization. It is estimated with Bayesian techniques using seven key macroeconomic variables: GDP, consumption, investment, prices, real wages, employment, and the nominal interest rate. The introduction of ten orthogonal structural shocks (including productivity, labor supply, investment, preference, cost-push, and monetary policy shocks) allows for an empirical investigation of the effects of such shocks and of their contribution to business cycle fluctuations in the euro area. Using the estimated model, we also analyze the output (real interest rate) gap, defined as the difference between the actual and model-based potential output (real interest rate). (JEL: E4, E5)