COVID-19: Monetary and fiscal policy measures to cope with the COVID-19 crisis in Europe

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Extended Abstract:
The COVID-19 crisis has caused an extremely large negative supply shock in countries such as Italy and Spain. In a context of low interest rates, the ECB has announced massive monetary injections to palliate the crisis. However, the dimension and extent of these shocks are asymmetric across European countries. Such countries that were more affected by the supply disruption will have to complement this policy measure with urgent fiscal measures. Our research question follows up from these facts. In face of a large but asymmetric disruption of economic activity in the euro area, what would be the optimal country-specific fiscal policy that should be implemented in conjunction with common monetary policy measures at the union level.

In order to answer this research question we aim at using the following methodology. We propose a DSGE model for policy evaluation. The model consists of two countries within a monetary union. Countries can be hit by asymmetric shocks. Monetary policy is characterized by a union Taylor rule constrained by the zero lower bound. Unconventional monetary policy is proxied by a money supply rule, which is also common to the union. Fiscal policy is country specific. Taking into account cross-country asymmetries, the model will serve to determine what the optimal fiscal policy will be, in the sense that it is welfare maximizing for the whole union.

Data Description:
Macroeconomic data on key variables such as GDP, employment, inflation, consumption, production, interest rates for model calibration

Keywords:
COVID-19, crisis, macroeconomy, euro area, monetary union, monetary policy, fiscal policy, recession, recovery, asymmetric shocks

JEL Classification:
E32, E58