Strategic Interactions and Contagion Effects under Monetary Unions

Paolo Canofari[a], Giovanni Di Bartolomeo[b], Giovanni Piersanti[a,b]

[a]University of Rome "Tor Vergata", [b]University of Teramo

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Abstract

This paper applies game theory and a cost-benefit analysis to study voluntary exits and contagion effects in countries joined to a monetary union. The paper looks at two noncore, or periphery countries of a large union and examines the role of structural asymmetries and strategic interactions as determinants of equilibrium outcomes, following both country-specific and common shocks. The paper finds that country-specific shocks are never associated to multiple equilibria and, if large enough, can spread to the other country leading to contagion. By contrast, common shocks are seen to sustain multiple equilibria, if almost-symmetric countries are considered, and to have implications similar to those found in the country-specific case if large structural asymmetries are admitted.

Jel codes: F30, F31, F41, G01.

Keywords: Shadow exchange rate, currency crisis, monetary unions, contagion, Nash equilibria.