Recessionary Wage Flexibility in a Monetary Union - A TANK approach*

We study the impact of wage flexibility on the transmission of economic shocks within a monetary union using a two-agent New-Keynesian small open economy model. Our analysis reveals that financially constrained households amplify the real income channel, leading to greater shock amplification when price flexibility is insufficient. The required degree of price flexibility depends on trade openness and the share of constrained households, but not on wage flexibility itself. These findings challenge the conventional wisdom regarding the benefits of wage flexibility in a monetary union.