Bianca De Paoli
30 Holmead Road, SW6 2JD, London
b.s.de-paoli@lse.ac.uk
http://personal.lse.ac.uk/DEPAOLI

Personal

Date of Birth	18 January 1979
Nationality	Brazil, Italy
Languages	Portuguese; English (Fluent); Spanish (Advanced)

Education

2001-2006	London School of Economics: PhD Economics
2000-2001	London School of Economics: MSc Economics with Distinction
1996-2000	Pontificia Universidade Catolica do Rio de Janeiro: BSc in Economics with Honours

Employment

2005 - Present	Economist, Monetary Instrument and Markets Division, Bank of England
2008	Visiting Lecturer, Master Programme, Pontificia Universidade Catolica do Rio de Janeiro
2007 – 2008	Visiting Lecturer, Undergraduate Programme, London School of Economics

Honours and Scholarships

Scholarship for PhD studies, CAPES, Brazil; S. C. Tsiang Scholarship, London School of Economics; LSE Research Studentship, London School of Economics; Scholarship for Undergraduate studies, CAPES, Brazil; CNPq, Brazil, Special Training Program Scholarship.

Refereeing Activities

American Economic Review; Journal of International Economics; International Economic Review; Journal of Economic Dynamics and Control; Journal of Macroeconomics; Journal of International Money and Finance; Oxford Economic Papers.

Current Affiliations

Bank of England and Centre for Economic Performance, London School of Economics.

Research

"Monetary Policy and Welfare in a Small Open Economy": *Journal of International Economics*, Vol. 77, Issue 1, February 2009.
Also available as: CEP Discussion Papers no.0639, May 2004.
This paper analyzes optimal monetary policy in a small open economy featuring monopolistic competition and nominal rigidities. It shows that the utility-based loss function for this economy can be written as a quadratic expression of domestic inflation, output gap and real exchange rate. The presence of an internal monopolistic distortion and a terms of trade externality drives optimal policy away from domestic inflation targeting and affects the optimal level of exchange rate volatility. When domestic and foreign goods are close substitutes for each other, the optimal policy rule implies lower real exchange rate volatility than a domestic inflation targeting regime. The reverse is true when the elasticity of substitution between goods is low.

"Optimal Monetary and Fiscal Policy for a Small Open Economy" (with Gianluca Benigno): CEPR Discussion Papers 7232, March 2009.

Also available as CEP Discussion Papers no.0905, January 2009.

This paper analyses the international dimension of fiscal policy in a small open economy framework. In our model, the fiscal authority finances government spending by levying distortionary taxation and issuing non-state-contingent debt. Our analysis identifies the presence of a real exchange rate externality and show that, once this open economy aspect of the policy problem is considered, it is no longer optimal to smooth taxes following idiosyncratic shocks. The paper also examines the implication of such externality for the optimal fiscal and monetary policy mix. We demonstrate that while in a closed economy case the introduction of nominal rigidities tends to increase the volatility of taxes relative to inflation, in an open economy, this is not necessarily the case.

"Monetary Policy in a Small Open Economy: the Role of the Asset Market Structure": CEP Discussion Papers no.0923, April 2009.

Can the structure of asset markets change the way monetary policy should be conducted in open economies? The debate surrounding optimal monetary policy in open economies has been extensive over the past decade. Many works have studied the role of the exchange rate in monetary policy and examined how trade balance dynamics can affect the analysis. However, technical difficulties have restricted the attention given to the capital account, net foreign asset positions and the structure of international asset markets in general. This study finds that, while price stability is suboptimal regardless of the configuration of asset markets, the performance of standard monetary policy rules is significantly affected by this configuration. Whereas under complete markets an exchange rate peg can outperform an inflation targeting regime if domestic and foreign goods are close substitutes to each other, the opposite holds when markets are incomplete.

"Optimal Bayesian policy under model uncertainty", (with Tim Cogley, Tony Yates and Kalin Nikolov), March 2007.

The aim of this paper is to answer the question: how should monetary policy be conducted in the face of multiple sources of uncertainty? These uncertainties may include: uncertainty about future shocks; uncertainty about the parameters within a policy model; and uncertainty about alternative model specifications. We apply Bayesian econometrics and Bayesian decision theory are in order to provide a unified way of answering this question. Using UK data, we estimate a set of dynamic general equilibrium models which includes a learning model, a small and a big scale New Keynesian model, a small open economy framework and a model with backward looking features. We then define a class of Taylor-like rules and search for the rule that delivers the best weighted performance across the models, where the weights are the posterior odds computed from the marginal data density of each model.

"Asset Pricing Implications of a New Keynesian Model" (with Alastair Scott and Olaf Weeken), Bank of England Working Paper no.326, June 2007.

To match the stylised facts of goods and labour markets, the canonical New Keynesian model augments the optimising neoclassical growth model with nominal and real rigidities. We ask what the implications of this type of model are for asset prices. Using a second-order approximation, we examine bond and equity returns, the equity risk premium, and the behaviour of the real and nominal term structure. We catalogue the factors that are most important for determining the size of risk premia and the slope and level of the yield curve. In a world of technology shocks only, increasing the degree of real rigidities raises risk premia and increasing nominal rigidities reduces risk premia. In a world of monetary policy shocks only, both real and nominal rigidities raise risk premia. The results indicate that the implications of the New Keynesian model for average asset returns depend critically on the characterisation of shocks hitting the model economy.

" Foreign exchange rate risk in a small open economy ", (with Jens Sondergaard), Bank of England Working Paper no.365, March 2009.
The forward premium anomaly refers to the empirical observation that high interest rate currencies tend to appreciate rather than depreciate as the risk-neutral uncovered interest rate parity (UIP) would imply. Part of the literature has attributed the failure of UIP to the existence of time varying foreign exchange risk premia. But resolving the forward premium puzzle requires a volatile FX risk premium that covaries negatively with the depreciation rate. This paper shows that a canonical general equilibrium small open economy model with consumption based external habit formation can only generate such a FX premium under certain assumptions namely: Households need to have slow-moving habits as well as incur very persistent output shocks. The results are shown to be independent of the origin of shocks. Moreover, the introduction of mechanisms that increase exchange rate volatility also help reconcile such puzzle.

"Why do risk premia vary over time? A theoretical investigation under habit formation", (with Pawel Zabczyk), Bank of England Working Paper no.361, February 2009.
Empirical evidence suggests that risk premia are higher at business cycle troughs than they are at peaks. Existing asset pricing theories ascribe moves in risk premia to changes in volatility or risk aversion. Nevertheless, in a simple general equilibrium model, risk premia can be procyclical even though the volatility of consumption is constant and despite a countercyclically varying risk aversion coefficient. We show that agents' expectations about future prospects also influence premium dynamics. In order to generate countercyclically varying premia, as found in the data, one requires a combination of hump shaped consumption dynamics or highly persistent shocks and habits. Our results, thus, suggest that factors which help match activity data may also help along the asset pricing dimension.

"Uncertainty and Monetary Policy: The Role of Precautionary Saving", (with Pawel Zabczyk), June 2008.
We use a New Keynesian model featuring external habit formation to assess the way in which the precautionary savings motive affects monetary policy transmission. We find that if productivity shocks are the main drivers of the business cycle, properly accounting for uncertainty reduces the magnitude of optimal monetary policy responses. However, when cycles are predominantly driven by demand shocks, the presence of uncertainty magnifies the required policy reaction.

Other works

"Costs of sovereign default", (with Glenn Hoggarth and Victoria Saporta), Bank of England Working Paper no.362, February 2009. Also available as: FS paper no.1, and Quarterly Bulletin, Bank of England, July 2006.
Over the past quarter of a century, emerging market economies (EMEs) have defaulted on their sovereign debts frequently. This article assesses the size and types of costs that have been associated with these defaults. It emphasises that costs, measured by the fall in output, are particularly large when default is combined with banking and/or currency crises. Output losses also seem to increase the longer that countries stay in arrears or take to restructure their debts. The paper concludes with a number of policy suggestions to improve debt crisis prevention and management and the role played by the IMF.