Figure 8 illustrates the possibility that there are multiple equilibrium thresholds. In the figure, there are two intersections of the function $\lambda \delta(u) + \mu + y^*$ with the (transformed) devaluation cost $V_{2c}$. (The parameters underlying the figure are $\alpha = 1$, $\theta = 0.15$, $y^* = 0.01$, and $\mu = 0.03^{11}$.) One threshold occurs at $\bar{u} = 0.0099$, and at it, the associated expected depreciation rate is $\delta(0.0099) = 1.23$ percent per period. The second equilibrium threshold is at $\bar{u} = -0.0234$. There, expected depreciation is $\delta(-0.0234) = 5.71$ percent per period. At this high expected depreciation rate, wage inflation creates a competitiveness problem and unemployment so painful that a devaluation will occur unless the output shocks hitting the economy are quite favorable. Thus, the relatively low credibility of the authorities in the second equilibrium is self-validating $^{(2)}$.

Economists so far have little to say about which particular equilibrium will occur in a situation where several are possible. In this model, however, any random event could trigger a shift from an equilibrium in which markets view devaluation as unlikely to one in which they view it as very likely. Figure 8 shows that the shift could even be from a situation where devaluation is viewed as impossible to one in which it is viewed as a near certainty. Such a shift would be accompanied by a sharp rise in

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$^{(1)}$ The choices $\alpha = 1$ and $\theta = 0.15$ make $\lambda = 0.87$, which corresponds to a rather accommodative government. With distributions for $u$ more complicated than the uniform, however, multiple equilibria (sometimes more than two of them) can arise under much less accommodative governments. See Obstfeld (1991).

$^{(2)}$ For the chosen parameters, note that when the public expects discretion to be exercised at $u = -0.03$ and above, the monetary authority has a substantial incentive to devalue, not revalue, even when $u = -0.03$. (Apply (34) and (35).) Thus, there was no loss of generality in assuming from the outset that revaluations never occur.