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A Comparison of the 'Rational Expectations' and 'General-to-Specific' Approaches to Modelling the Demand for M1

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Abstract

This paper compares the "forward-looking" and "general-to-specific" approaches to modeling the demand for M1 in the United Kingdom. The authors show that the "forward-looking" models lead to a restrictive dynamic structure compared to models obtained using the alternative approach. Models derived using the "general-to-specific" approach also seem to be preferable to "forward-looking" models in that they yield more plausible long-run properties. The authors also employ variance-encompassing tests to discriminate between the two approaches. Copyright 1989 by Blackwell Publishing Ltd

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