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Can Currency Demand Be Stable under a Financial Crisis? The Case of Mexico

Published: 01 January 2001

Volume 48, pages 344–366 (2001) Cite this article



IMF Staff Papers

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Abstract

The paper finds strong evidence that real currency demand in Mexico remained stable throughout and after the financial crisis in Mexico. Cointegration analysis using the Johansen-Juselius technique indicates a strong cointegration relationship between real currency balances, real private consumption expenditures, and the interest rate. The dynamic model for real currency demand exhibits significant parameter constancy even after the financial crisis as indicated by a number of statistical tests. The paper concludes that the significant reduction in real currency demand under the financial crisis in Mexico could be appropriately explained by the change in the variables that historically explained the demand for real cash balances in Mexico. This result supports the Bank of Mexico's use of a reserve money program to implement monetary policy under the financial crisis.

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About this article

Cite this article

Khamis, M., Leone, A. Can Currency Demand Be Stable under a Financial Crisis? The Case of Mexico. *IMF Econ Rev* **48**, 344–366 (2001). https://doi.org/10.2307/4621673

Published
01 January 2001

Issue date
01 April 2001

DOI
https://doi.org/10.2307/4621673

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