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Forecasting Real GDP: What Role for Narrow Money?

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Hochschule Wismar

Franz Seitz (https://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=165149)
Technical University of Applied Sciences Weiden

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Abstract

This paper analyses the information content of M1 for euro area real GDP since the beginning of the 1980s and reviews theoretical arguments on why real narrow money should help predict real GDP. We find that, unlike in the U.S., in the euro area, M1 has better and more robust forecasting properties for real GDP than yield spreads. This property persists when one controls for a number of other influences. We also evaluate the out-of-sample forecasting performance of different classes of VAR models comprising real M1, GDP and other indicators, using as benchmark a simple univariate model. As a result, only VARs in first differences are able to outperform the benchmark.

Keywords: Money, business cycle, forecast comparison, VAR models

JEL Classification: E41, E52, E58

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