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# money demand system for euro area M3

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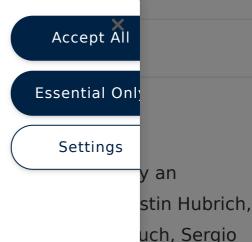
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## **Abstract**

In order to assess the importance of monetary and financial developments for key macroeconomic variables in the euro area a money demand system for M3 is estimated adopting a structural cointegrating VAR approach. While maintaining a good statistical representation of the data, long-run relationships are based on economic theory. By using generalized response profiles the dynamics of the money demand system is investigated without any further identifying assumptions. Error bounds of the profiles are derived using bootstrap simulations.

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Nicoletti-Altimari, Huw Pill, Mette Felding Schrøder, Juan-Luis Vega, Javier Valles and Jürgen Wolters. The views expressed in this paper represent exclusively the opinion of the authors and do not necessarily reflect those of the European Central Bank. The usual disclaimer applies.

## Notes

<sup>1</sup>The main components of M3 are currency in circulation and overnight deposits (M1), other short-term deposits (M2-M1: deposits with an agreed maturity of up to two years; deposits redeemable at notice up to three months) and marketable instruments (M3-M2: repurchase agreements; debt securities issued with a maturity of up to two years; money market fund shares/units and money market paper).

<sup>2</sup> The own rate series used in figs. 1–3 was constructed from German, French, Italian, Spanish and Dutch interest rates aggregated using ECU conversion rates. In terms of GDP ratios, these data capture more than 80% of the euro area.

<sup>3</sup> In order to save space the results are not presented here. They are available from the authors upon request.

<sup>4</sup> In the estimation  $\pi_t$  is used instead of  $\pi_{t+1}$ .

<sup>5</sup> The estimation and testing of the model was carried out in PCFiml 9.0 (Doornik and Hendry (1997)).

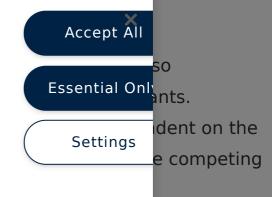
<sup>6</sup> The VECM has two lags selected by standard information criteria like Akaike's information criterion.

<sup>7</sup> Note that the second cointegrating vector is normalized in  $\pi$  + and not in  $I_{\pm}$  as in

Equation

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<sup>9</sup> According to tests of overidentifying restrictions the parsimonious representation is not rejected by the data.

<sup>10</sup> The operator diag<sup>-1</sup>(β΄Σβ) is writing the diagonal elements of (β΄Σβ) into a diagonal matrix of the same dimension and  $(\cdot)^{-1/2}$  refers to an element-wise operations.



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