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► Volume 12, Issue 11 ► The information content of M0 in the Uni ....

Original Articles

The information content of M0 in the United Kingdom

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Abstract

This paper examines the empirical characteristics of target–goal relationships between M0 on the one hand, and output, prices, interest rates and the current account balance on the other hand, in terms of a good intermediate target and informational variable. The results of a five-variate vector error correction model are indicative of feedback relationships between M0 and output, prices and output, and prices and M0, which is consistent with the Keynesian 'monetary accommodation' hypothesis. The finding of a reverse causality from output, prices and interest rates to M0 suggests that M0 may not serve well as a good intermediate target and informational variable of British monetary policy. The evidence therefore suggests the reduced effectiveness of monetary targeting strategy as a stabilization tool.

Acknowledgements

Notes

For example, see Barnhart and Darrat ([1992](#)), Barnhart and Wallace ([1994](#)) and Breedon and Fisher ([1996](#)).

For example, see McMillin and Fackler ([1984](#)).

The studies of Barnhart and Darrat ([1992](#)), Henry and Pesaran ([1993](#)) and Chrystal and MacDonald ([1994](#)) also suggest leading indicator properties of M0 with respect to inflation.

Interested readers are referred to Judge et al. ([1988](#)), Sims ([1980](#)) for detailed derivation of the moving average representation and the calculation of VDCs.

Because of data availability the sample period of the M0 system runs from 1969:2–1997:4.

The maximum lag length chosen was a 12 quarter lag. Econometrically, the choice of maximum lag is designed to avoid a possible bias due to the exclusion of important lags, as well as the fragility of inefficient parameter estimates induced by an over-specified lag order. For a discussion on the consequences of under-specification and over-specification of lag length, see Hisao ([1981](#)). Theoretically, the choice of a 12 quarter lag would allow for the complete realization of impacts due to a given monetary disturbance.

To test the sensitivity of the VDC results, the following ordering option have been used also (r, m, y, p, c). In the second ordering the interest rate variable is placed before money stock to account for the fact that the UK official authorities pursued interest rate targeting over a long period of time. However, no significant changes were observed as a result of such reordering. This may be due to the low levels of contemporaneous correlation among residuals across equations.

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