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Volume 27, 2020 - Issue 1

267 | 6
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The demand for Divisia money in the United States: evidence from the CFS Divisia M3 aggregate

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Pages 41-45 | Published online: 17 Apr 2019

Cite this article <https://doi.org/10.1080/13504851.2019.1606403>

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ABSTRACT

In this paper, we analyse the demand for real money balances in the United States for the period 1990Q1–2017Q2 using a novel Divisia monetary aggregate developed by Barnett et al. (2013). Unlike simple-sum aggregates, Divisia aggregates take into account the different degrees of ‘moneyness’ of each monetary asset. In addition, Divisia aggregates have shown to be empirically superior to simple-sum aggregates, providing stable money demand functions for different periods and countries. In a first stage, we test for cointegration and estimate a long-run equilibrium model. In a second stage, we estimate an error correction model to study the short-run dynamics. Consistent with previous research, our findings show the existence of a stable money demand function, which suggests that monetary aggregates, when properly measured, can be useful tools in the conduct of monetary policy.

KEYWORDS:

Divisia

money demand

monetary aggregate

cointegration

JEL CLASSIFICATION:

C22

E41

E51

Acknowledgments

We gratefully acknowledge the financial support of the Spanish Ministry of Economy and Competitiveness under projects ECO2017-84864-P and ECO2016-75631-P.

Disclosure statement

No potential conflict of interest was reported by the authors.

Correction Statement

This article has been republished with minor changes. These changes do not impact the academic content of the article.

Notes

¹ Sources: <https://research.stlouisfed.org/> and <http://www.centerforfinancialstability.org/>

² The nominal series has been deflated using the GDP deflator.

³ When using Divisia monetary aggregates, the preferred opportunity cost measure is the user cost of money (Belongia and Ireland [2017](#)). However, the choice of interest rate is of little importance in the context of our study. Hoffman, Rasche, and Tieslau ([1995](#)) point out that, since interest rates are normally cointegrated, the use of different measures of the opportunity cost of money should not change the

cointegrating relationship among variables. Since our aim is to demonstrate the existence of a stable money demand function, the choice of interest rate should not affect the results.

⁴ The use of dummy variables in this context finds justification in money demand literature. See, for instance, Dreger and Wolters (2010) or Anderson, Bordo, and Duca (2017).

⁵ Their estimates range between 0.70 and 0.90 for broad money aggregates (CFS Divisia M2 and CFS Divisia MZM) over the period 1983–2017.

⁶ Unlike our initial model, this model excludes the deterministic trend for two reasons. First, when we include the trend, the variable representing the transactions demand for money becomes negative. Second, the opportunity cost of money, as measured by the three-month US Treasury Bill, becomes non-significant. These two results are at odds with both the theoretical and empirical literature on money demand, suggesting that the model is mis-specified when the trend is introduced.

Additional information

Funding

This work was supported by the Spanish Ministry of Economy and Competitiveness under research projects ECO2017-84864-P and ECO2016-75631-P.

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