

Dynamic econometric modelling of money demand and policy
analysis under Japan's previous normal interest rate and current near
zero interest rate periods

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Abstract

This paper carries out a number of analyses centring on money demand, the velocity of money and the opportunity cost of holding money. For the analysis, we divide the dual-interest sample period into two periods (a normal interest rate and a near zero interest rate period) and quantify the sensitivity of money demand with respect to the cost of holding money by applying rigorous Johansen's co-integration method of analysis. The results revealed that the sensitivity of money demand with respect to the cost of holding money is five times higher in the near zero interest rate period than in the normal interest rate period which is consistent with economic theory. In addition, this paper sheds light on the economic implications of the quantitative monetary easing policy and the structure of the Japanese economy. This paper also makes a policy recommendation to lower the eligible voting age in Japan so as to achieve long-term economic growth.

Keywords: Quantitative Easing Monetary Policy, Multivariate Structural Vector Autoregression, Money demand, Liquidity trap
JEL Classification: C32, E41, E50

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