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Inflation and the Evolution of Firm-Level Liquid Assets

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Abstract

This paper shows that inflation has been an important determinant of firm-level liquid asset holdings. Liquid assets as a share of total assets – the cash ratio – for U.S. corporations steadily declined from the 1960s to the early 1980s, and has since steadily increased. Our empirical analysis finds that inflation is a key factor accounting for these changes. We show that these liquid asset holdings are imperfectly hedged against inflation. Hence, changes in inflation alter the real value of a firm's liquid asset portfolio causing them to readjust these balances.

Keywords: Cash Holding; Inflation; Liquidity; Liquid Assets; Cash Ratio.

JEL Classification: G3; G32; E31.

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