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Ivo J.M. Arnold , Beau Soederhuizen

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The missing spillover of base expansion into monetary aggregates:

Is there a puzzle?

vo J.M. Arnold^{1,2} and Beau Soederhuizen²

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¹Erasmus School of Economics, Erasmus University Rotterdam, P.O. Box 1738, 3000DR, Rotterdam, The Netherlands. email: arnold@eur.ee.nl.

²Nyenrode Business Universiteit, Breukelen, Staatweg 25, 3621BG, Breukelen, The Netherlands, email: b.soederhuizen@nyenrode.nl.

Abstract

The seeming impotence of monetary base expansion to influence money growth during the Global Financial Crisis and the European sovereign debt crisis, can be regarded as a puzzle. A possible explanation is that central banks have used unconventional monetary policies to pursue multiple objectives: to stabilize the financial system and to stimulate the economy. While achieving the latter objective may result in a positive spillover of base money into money growth, this does not necessarily hold for the former objective. This paper aims to disentangle these effects by estimating a state space model in which the monetary base is adjusted for distortions arising from the instability in financial markets. We find that stress in financial markets, measured by various indicators, has significantly affected the relationship between base growth and money growth in the EA, but not in the US.

Keywords: monetary policy, money supply, financial markets

JEL codes: E44, E51, E52, E58

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