



BANCA D'ITALIA
EUROSISTEMA

Temi di discussione

(Working papers)

Excess money growth and inflation dynamics

by Barbara Roffia and Andrea Zaghini

January 2008

Number

657

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EXCESS MONEY GROWTH AND INFLATION DYNAMICS

by Barbara Roffia* and Andrea Zaghini**

Abstract

The paper analyzes the short-run impact of periods of strong monetary growth on inflation dynamics for 15 industrialized economies. We find that when robust money growth is accompanied by large increases in stock and house prices and loose credit conditions, the probability of recording an inflationary outburst over a three-year horizon is significantly increased. In contrast, significant money stock expansions which are not associated with sustained credit increases and strong dynamics in other asset prices seem to be less likely to have inflationary consequences and thus, less worrying from a policy perspective.

JEL Classification: E31, E40

Keywords: Inflation, money growth, quantity theory of money

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1.Introduction¹

The existence of a positive relationship between money and prices in the long run is well acknowledged in economic literature. A large consensus can be found on both the direction and the dimension of the effect of an increase in the monetary aggregate (regardless of the definition adopted) on price developments. The statement that, in equilibrium, monetary policy is neutral (i.e. it does not affect real economic variables such as consumption and output but it has only a nominal impact) hinges on the quantity equation, which in turn defines a positive “one-to-one” relationship between monetary and price growth: after an increase in money stock prices will rise eventually in the same proportion. The theoretical consensus on money neutrality is also supported by well-documented empirical evidence, in both time-series and cross-countries analyses.²

The economic profession, however, highlights that, since money is not the sole cause of price developments in the short run, a certain period of time must elapse before the “one-to-one” relationship emerges. In fact, there are other factors that may temporarily affect price dynamics and hide the longer-term money neutrality. This implies that, in order to forecast inflation, monetary aggregates may not show good leading properties in the short-to-medium run. Indeed, the role of money as an informational variable for monetary policy decisions is an open issue. Empirical works provide mixed results and the findings seem mainly to depend on the selected countries and the historical periods considered.³

The aim of the paper is to shed some light on the reasons why some robust money growth episodes lead to inflation even in the short-run while others do not. In particular, we check whether the development in asset prices and credit dynamics might

¹ The authors would like to thank Ben Steil, Alessandro Calza, Sergio Nicoletti Altimari, Huw Pill, Lars Risbjerg, Frank Smets, Andrea Tiseno and Thomas Westermann for helpful discussions and useful suggestions together with two anonymous referees and participants at the XIV Tor Vergata Conference on Banking and Finance, the LXI European Meeting of the Econometric Society and the ECB Workshop “The role of monetary analysis in monetary policy”. The views expressed in the paper do not necessarily reflect those of the European Central Bank or the Bank of Italy.

² See for instance Lucas (1980), Lothian (1985), McCandless and Weber (1995), Jaeger (2003), Gerlach and Svensson (2003) and Benati (2006) among many others.

³ A non-exhaustive list includes Stock and Watson (1999), Dwyer and Hafer (1999), Trecroci and Vega (2000), Nicoletti Altimari (2001), Leeper and Roush (2002).

contribute positively to the triggering of an inflationary outburst. The analysis of the inter-relationship between money, credit and asset prices, which can be dated at least as far back as Kindleberger (1978), has recently regained relevance in the current context of low and stable inflation in almost all industrialized economies. In such an environment, inflationary pressures normally associated with unsustainable developments in real and financial variables may take longer to emerge and symptoms may show up in advance in excessive credit and asset price growth (Bordo and Jeanne, 2002; Borio and Lowe, 2002; Machado and Sousa, 2006).

In addressing our goal we rely on a technique employed by a recent strand of the empirical literature on credit and asset prices developments (Borio and Lowe, 2004; Detken and Smets, 2004; Van den Noord, 2006). Instead of focusing on the joint statistical properties of the two time series of money and inflation over time – as traditionally done when assessing the quantity theory (Bachmeier and Swanson, 2005; De Grauwe and Polan, 2005; Bruggeman et al., 2005; Assenmacher-Wesche and Gerlach, 2006a) – we focus only on carefully chosen episodes of sustained money growth which ex-ante are supposed to have a high probability of leading to an inflationary outburst.

We first identify 71 periods of robust monetary growth over the last three decades in 15 industrial economies and we find that only in around 50 per cent of the cases did inflation actually follow over a three-year horizon. We then check via probit regressions whether the probability of inflation occurring after those episodes is influenced by the behavior of a set of macroeconomic and financial variables. The empirical evidence gathered supports the view that when robust money growth is accompanied by large increases in stock prices, house prices and loose credit conditions an inflationary outburst is likely to follow in the short run.

A direct policy implication stemming from our findings is that money growth must be seen as more dangerous for price stability when accompanied by strong credit and asset price growth. In contrast, robust money growth which is not associated with sustained credit expansion and strong dynamics in asset prices seems to be less likely to have inflationary consequences and thus, less worrying determinants are to be investigated regarding its evolution.

The paper is structured as follows. Section 2 illustrates the dataset and proposes a brief cross-section and pooled panel analysis of money and price developments; Section 3 deals with the selection criteria of money growth episodes; in Section 4 we present an econometric investigation of the circumstances that may lead to an inflationary outcome and in Section 5 we discuss the results from several robustness checks. Finally, Section 6 draws some conclusions by relating our results to the current empirical literature.

2. A preliminary look at the data

The study analyzes the development of financial, real and monetary indicators around periods of strong monetary growth. In particular, we made use of historical series of a broad monetary aggregate, roughly equivalent to M2 or M3 (depending on the country considered) and year-on-year changes in the consumer price index. As for asset prices, we considered stock market developments (represented by the share price index available for each country) and house price dynamics. Macroeconomic variables include nominal and real GDP, output gap and nominal investment (gross fixed capital formation), while financial variables are represented by the short-term (three-month money market) and long-term (ten-year government bond yield) interest rates and the nominal and real effective exchange rates. With regard to credit, we use credit to the private sector (or loans to the private sector when available). We also considered several indices of oil and commodity prices and indicators of fiscal sustainability.⁴

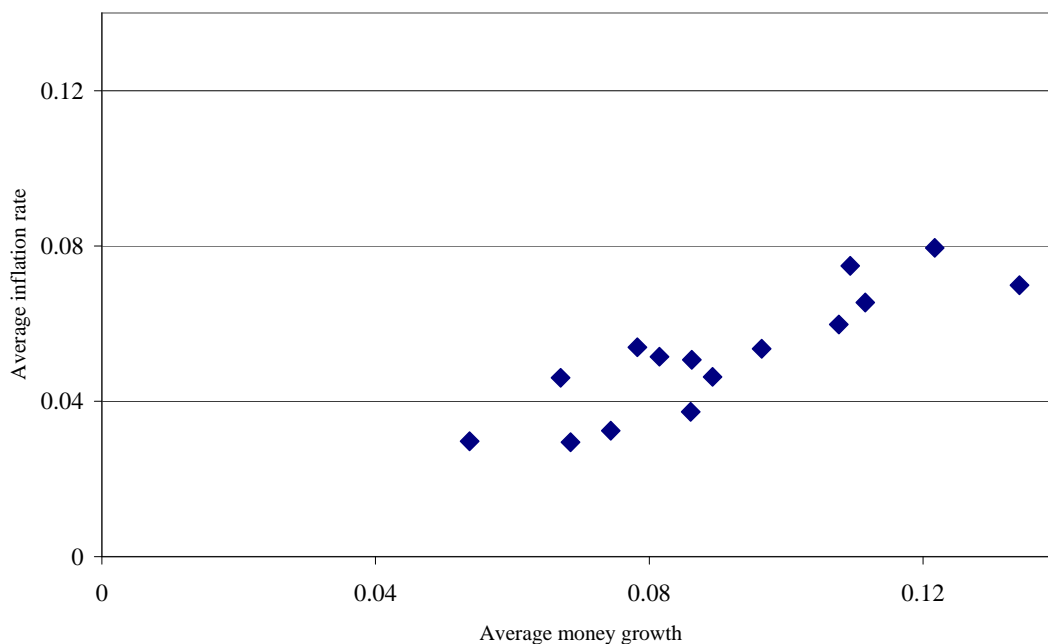
The dataset used for the analysis consists of quarterly data collected for 15 main industrial economies and spans more than three decades. Whenever available, data start in 1970 Q1 and end in 2006 Q1. The countries considered are: Australia, Canada, Denmark, France, Germany, Italy, Japan, the Netherlands, New Zealand, Norway, Spain, Sweden, Switzerland, the United Kingdom and the United States. The average growth rate of the monetary aggregate over the whole sample ranges from five per cent in Switzerland to 13 per

⁴ All series are seasonally adjusted. Whenever available, quarterly series are calculated as averages of monthly series. For a detailed description of the series used and their sources see the Appendix.

cent in New Zealand, while average inflation is at the lowest rate in Germany (three per cent) and at the highest rate in Spain (eight per cent).

Before starting our analysis of the short-run linkage between money and prices, we check the quantity theory tenet for the long run.⁵ We run this preliminary assessment because the long-run relation between money and prices has recently been questioned by De Grauwe and Polan (2005) for countries displaying a low level of inflation. Since the countries in our sample are all included in their group of low level inflation economies (and low level of money growth), we briefly replicate their main analyses simply to shed some light on the statistical properties of our data set. It would be indeed questionable to investigate a “milder” short-run relation if the “stronger” long-run relation were not to hold in our sample.

Figure 1 Average inflation and money growth across countries



⁵ Note that in the paper we use the wording “short run” to refer to a period different from the “long run”, which in the money-inflation literature is often much longer than our horizon of three years. For instance, Fitzgerald (1999) suggests for the US a period of eight years, while Smets (2003) hints at a medium-term of four years for the euro area. In addition, there is ample evidence in the VAR literature for the main industrialized economies that after three to four years monetary policy shocks still have significant real effects on the economy (usually GDP’s response peaks at eight to 12 quarters and then slowly declines) and thus that the long run has not yet started after that amount of time. Our “short-run” definition might thus be interpreted as a short-to-medium run.

With respect to the study of De Grauwe and Polan (henceforth DeGP) we have fewer countries (15 in our sample *versus* 32 in their cross-section analysis), but longer time series (37 years *versus* 30). Figure 1 depicts the scatter plot for the 15 countries of the averages of their money and price growth rates over the whole time span (1970-2006). Even though the points are clearly below the 45 degree line, the two variables exhibit a strong positive correlation and they are far from depicting a “shapeless and almost horizontal cloud” as instead is the case for the DeGP set of countries. A simple regression of the growth rate of prices on money and real GDP confirms the visual intuition. Table 1 reports the estimates on our sample (Panel A) and the values in DeGP (Panel B).⁶ Although the coefficient on money growth (0.703) is below unity, it is much larger than the one reported in DeGP (0.250) and significantly different from zero.

Table 1 Results of OLS estimations

Variable	(Panel A)			(Panel B)		
	Coefficient	Std Error	p-Value	Coefficient	Std Error	p-Value
Constant	0.004	0.008	0.653	4.750	2.145	0.035
Broad Money	0.703	0.142	0.000	0.250	0.187	0.200
GDP	-0.601	0.487	0.242	-0.280	0.219	0.209

Note: White HCSE & Covariance.

In addition, the panel regressions run following DeGP’s analysis, which take advantage of both cross-section and time-series dimensions of the data set, seem to support the idea that our sample is well suited to investigate the relation between money and prices in the short run. Table 2 shows the results of a pooled (homogeneous) OLS regression and a fixed-effect regression. The coefficient on money growth suggests an impact adjustment of prices to changes in the broad monetary aggregate of around 0.3. Given that this is a contemporaneous relation, whereas the quantity theory postulates a long-run unitary relation between the two variables, the results can be considered fairly satisfactory. In comparison, DeGP report a

⁶ The data are taken from Table 6 on p. 250 of De Grauwe and Polan (2005).

lower fixed-effect estimate of 0.2005 for the whole sample and 0.1663 for the low inflation countries.

Summing up, the evidence in favor of a positive long-run relation between money growth and inflation is strong, even though the brief analysis proposed cannot be considered exhaustive. The fact that we are using a much more homogeneous sample of advanced economies and with a more reliable data releasing process may explain the large differences with the DeGrauwe and Polan's results. In the following section we propose a way in which phases of robust money growth might be selected to investigate from a favorable perspective the short-run relation between money development and inflation dynamics.

Table 2 Results of panel estimations

Variable	(Pooled OLS)			(Fixed effects)		
	Coefficient	Std Error	<i>p</i> - Value	Coefficient	Std Error	<i>p</i> - Value
Constant	0.022	0.003	0.000	0.026	0.003	0.000
Broad money	0.329	0.025	0.000	0.289	0.026	0.000

3. Episode selection

The main aim of the paper is to analyze the relation between money and prices in order to check whether the positive causality implied in the quantity equation holds also over a relatively limited time span. Thus, by carefully selecting periods of robust monetary increase, we try to place us in the most favorable condition to assess the one-to-one quantity theory prediction. In particular, to select phases of “excessive” money growth we make use of a measure proposed by Borio and Lowe (2004), who focus their attention on the cumulative building of imbalances. The idea is that vulnerabilities are generally built up over an extended time, rather than in a single period such as a month or a quarter.

Borio and Lowe suggest looking at the “money gap” measure, which is defined as the deviation of the ratio of money to GDP from its trend. The trend is here calculated using a

Hodrick-Prescott filter (with a smoothing parameter of 1600) over the whole sample.⁷ Starting from this principle, we sorted out only periods of continuous imbalances, namely our episodes are selected according to their length. In particular, we selected an episode only when the deviation of the ratio of money to GDP from trend persisted for at least one year (four consecutive quarters). The only exception was that, when we found a single negative quarter within an already established episode, we considered it part of the excessive money growth period. As an example, during the eight quarters from 1984 Q4 to 1986 Q3, Australia witnessed only one quarter (1985 Q2) in which the ratio of money to GDP was (slightly) negative. We thus considered the full eight-quarter length instead of starting the episode from 1985 Q3.⁸

In order to have three years of data after the end of each episode, we considered only episodes ending before 2003 Q1, so that the available number of cases turned out to be 71 (see Table 3). Although for each country at least two episodes can be recorded, episodes are not evenly distributed among countries, partly due to different data availability. More precisely, Australia witnessed nine episodes, followed by Norway, Sweden and the United States which experienced six episodes. France and Switzerland, at the opposite, underwent only two and three episodes, respectively. Fifteen episodes occurred in the 1970s, 23 in the 1980s, 27 in the 1990s and six ended after 2000. The length of the episodes ranges from four to 20 quarters. In particular, there are 32 cases which lasted less than two years (four to eight quarters) and 39 with a length between two and five years (nine to 20 quarters). Finally, it is worth noting that the list of the selected episodes is consistent with the periods of financial distress identified by the empirical literature (Bordo et al., 2001; Borio and Lowe, 2002; Detken and Smets, 2004; Van den Noord, 2006).

⁷ In the same vein we constructed the gap measures for credit to the private sector, stock prices, house prices, output, inflation and investment.

⁸ According to this rule, we adjusted the length of six episodes, which would have been selected anyway, and added one episode of seven quarters, which instead would not have been selected according to the four consecutive quarter rule. However, the results of the paper are not affected by this marginal adjustment. See Section 5 for robustness checks about both the selection criterion and the inflation assessment.

Table 3 Episodes of “excessive” monetary growth

Country	Money growth gap>0%	No. of quarters	No. of epis.	Inflat. epis.	Country	Money growth gap>0%	No. of quarters	No. of epis.	Inflat. epis.
Australia	1972 Q4 - 1974 Q2	7	9	yes	New Zealand	1981 Q1 - 1981 Q4	4	4	no
	1975 Q2 - 1976 Q1	4		no					
	1977 Q4 - 1978 Q4	5		yes					
	1980 Q1 - 1981 Q2	6		no					
	1983 Q1 - 1983 Q4	4		no	Norway	1971 Q4 - 1973 Q2	7	6	yes
	1984 Q4 - 1986 Q3	8		yes					
	1989 Q3 - 1991 Q4	10		no					
	1996 Q4 - 1997 Q3	4		no					
1999 Q1 - 2000 Q1	5	yes	1979 Q1 - 1979 Q4	4	yes				
Canada	1972 Q1 - 1972 Q4	4	5	yes	1988 Q1 - 1989 Q1	5	20	no	
	1978 Q4 - 1983 Q1	18		no					
	1986 Q4 - 1987 Q3	4		no					
	1990 Q3 - 1993 Q4	14		no					
	1996 Q1 - 1998 Q4	12		yes					
Denmark	1975 Q4 - 1978 Q1	10	4	yes	Spain	1984 Q1 - 1985 Q4	8	4	no
	1984 Q2 - 1988 Q4	19		no					
	1992 Q2 - 1994 Q3	10		yes					
	1996 Q4 - 1999 Q3	12		yes					
France	1990 Q3 - 1993 Q4	14	2	no	1989 Q2 - 1991 Q3	10	5	no	
	1995 Q3 - 1996 Q3	5		no					
Germany	1982 Q1 - 1985 Q2	14	4	no	Sweden	1973 Q1 - 1975 Q4	12	6	no
	1988 Q1 - 1990 Q2	10		yes					
	1993 Q2 - 1994 Q4	7		no					
	1998 Q4 - 2000 Q2	7		yes					
Italy	1978 Q1 - 1980 Q1	9	4	yes	Switzer-land	1977 Q1 - 1980 Q1	13	3	yes
	1984 Q4 - 1987 Q4	13		yes					
	1992 Q2 - 1994 Q4	11		no					
	1996 Q2 - 1997 Q1	4		no					
Japan	1971 Q3 - 1974 Q1	11	5	yes	United Kingdom	1972 Q1 - 1975 Q1	13	5	yes
	1978 Q4 - 1980 Q2	7		yes					
	1981 Q4 - 1984 Q1	10		no					
	1987 Q2 - 1991 Q3	18		no					
	1998 Q1 - 1999 Q4	8		no					
Nether-lands	1982 Q2 - 1983 Q2	5	4	no	United States	1971 Q3 - 1973 Q3	9	6	yes
	1989 Q3 - 1991 Q1	7		no					
	1992 Q4 - 1994 Q4	9		no					
	1998 Q4 - 2000 Q2	7		yes					
						1976 Q2 - 1978 Q2	9		yes
						1982 Q3 - 1983 Q4	6		yes
						1986 Q2 - 1988 Q3	10		yes
						1990 Q4 - 1993 Q4	13		no
						2001 Q3 - 2003 Q1	7		yes

Note: All samples start in 1970, with the exception of France (1981 Q4), Germany (1975 Q4), Italy (1977 Q1), Netherlands (1978 Q1), New Zealand (1979 Q4) and Spain (1981 Q4).

Once the set of excessive money growth episodes has been determined, “inflationary” and “non-inflationary” episodes are distinguished on the following basis. We looked at the

average increase in both the consumer price index (i.e. inflation) and the inflation gap – defined as the difference between the inflation rate and its trend value – in the three-year period after the end of the monetary episode. Then, we labeled “inflationary” all the excessive money growth episodes that were followed by an increase in these two variables of at least one time the standard deviation. In other words, we compared the average value of each of these two indicators over the 12-quarter period after the end of the episodes with their corresponding average value over the episode length.

When the difference was more than one time the standard deviation, we labeled the money growth episode “inflationary”.⁹ Note that the time span considered is in line with the idea of short-run horizon and consistent with the time intervals that have been adopted in a number of inflation targeting regimes (Stevens, 2003). In addition, we regarded as inflationary also those episodes in which the consumer price index or the inflation gap peaked at values more than twice the standard deviation in any of the quarters of the three-year period following the episode, although the overall average increase was less than once the standard deviation. According to the latter rule, we could add other six cases for a total of 33 inflationary episodes (see Table 3).

Thus, surprisingly, the inflationary outcome characterizes less than half of all episodes. Even selecting those episodes for which the period of excessive money growth was lengthy and which thus *ex ante* were supposed to have a higher probability of becoming inflationary, only in 46 per cent of the cases did inflation occur within the three-year period following them.¹⁰ It is also worth noting that the relative share of inflationary episodes is significantly different across countries. For instance, in the United States and Norway five out of six of the episodes of strong monetary increase were followed by a significant acceleration

⁹ Given the broad time span of our sample, we considered the standard deviation of both inflation and inflation gap in each separate decade. Thus, for instance, in order to be classified inflationary episodes in the 1970s had to breach a much larger threshold than those of the 1990s.

¹⁰ In the same spirit as ours, De Gregorio (2004) finds that episodes of strong money growth in M2 (with an average length of 31 months) are not usually followed by significant increases in inflation within the next 12 months.

of inflation, while in Sweden and Spain only once out of six and five episodes respectively did periods of excess money growth lead to inflation.¹¹

In order to control for the macroeconomic and financial context in which the robust money growth phases unfolded, Table 4 shows the average values of a set of variables which may possibly serve as useful indicators of the building up of inflationary pressures. More precisely, the table reports, for each variable, the average value (across countries and periods) during each type of episode.¹²

Table 4 Average levels of macroeconomic variables

	Inflationary episodes	Non-inflationary episodes
Real stock price gap	1.91	-1.61
Real stock price growth	5.32	6.78
Real house price growth	3.44***	0.54***
Real GDP growth	3.25***	1.92***
Investment growth	8.08***	3.31***
Credit gap	0.90	0.78
Nominal short-term interest rates	7.39***	8.85***
Nominal long-term interest rates	8.03***	9.25***
Real short-term interest rates	2.91***	4.16***
Real long-term interest rates	3.55***	4.57***
Nominal effective exchange rate	-1.16	-0.53
Real effective exchange rate	-0.52	-0.60

Note: The values in bold denote statistical significance at 1% ("****") and 5% ("***").

In particular, we checked whether the differences in the means across episodes are statistically significant using the mean test based on a single factor, analysis of variance (ANOVA). The values in bold denote the means that are statistically different across episodes. It should be noted, however, that this simple analysis is bivariate in nature and does

¹¹ As regards the 38 periods that were not followed by a significant increase in inflation, in 23 cases the inflation gap was almost unchanged, in four cases it increased slightly, and 11 times it actually decreased, but significantly only in four episodes. Also note that in the present analysis we do not control for the effect of interest-rate changes on money velocity, which may have affected the link between money and inflation. Assenmacher-Wesche and Gerlach (2006b) show that, when taking this into account, the quantity theory of money is somewhat strengthened.

¹² A similar analysis based on the median values leads to the same conclusions.

not provide any insight into how developments in a single variable are interrelated with one another around the excess money growth episodes. This type of issue is instead analyzed in the next section. Bearing this caveat in mind, the following observations are worth noting.

First, business cycle fluctuations during inflationary and non-inflationary money growth episodes are different. In fact, the average growth rate of both real GDP and gross fixed capital formation is significantly higher during inflationary phases than in non-inflationary phases. Second, both the money and the credit gaps are higher during the periods leading to an inflationary outburst even though significantly so only for the money gap. Third, interest rates (regardless whether nominal/real or short/long-term) are significantly lower during the inflationary episodes. Fourth, asset price dynamics suggest that, during the inflationary episodes, both house prices and stock prices were growing vigorously, with the average rate of growth in house prices being significantly larger than during the non-inflationary episodes.

The picture that emerges from this preliminary analysis is that inflationary episodes appear to be associated with increased asset prices and credit gaps and they occur at times of relatively high GDP growth. They are accompanied by a fairly loose monetary policy stance, signaled by lower interest rates, while the international value of the currency does not seem to play any role. In contrast, non-inflationary episodes are characterized by relatively subdued growth, are not associated with particular asset price boom and bust cycles and show higher interest rates both in nominal and real terms. In the remainder of the paper we try to shed some light on the relevance of financial and macroeconomic performance for the development of price pressure.

4. An econometric investigation

This section provides an econometric investigation of whether various financial and macroeconomic variables help to distinguish inflationary from non-inflationary periods of excessive money growth. The study rests on probit regressions for the 15 economies under analysis. In particular, from the selection criterion highlighted in Section 3, we can construct the dependent variable. By attaching a “1” to the inflationary episodes and a “0” to the non-inflationary ones, we end up with an array of 38 zeros and 33 ones. For each period of

excessive money growth we consider the average value of the relevant variables during the episode. More specifically, given the episodes of strong monetary growth, we estimate how the probability of incurring a significant increase in inflation can be explained by a set of regressors, denoted as x :

$$(1) \quad \Pr(\text{InflOut} \neq 0 | x) = \Phi(\beta' x),$$

where Φ is the standard cumulative Normal distribution and β is the vector of coefficients.

The vector x of explanatory variables can be divided into three groups. The first set is made up of conventional determinants of the current and future inflation rate, the second set relates to financial factors that may have an impact on the development of the consumer price index, while the third set concerns some specific characteristics of the selected episodes. More precisely, as for the variables that most likely influence inflationary dynamics and money demand, we referred to real short-term interest rates, indicators of the business cycle (GDP growth rate), exchange rate measures (nominal and real effective exchange rate), commodity price indices and measures of fiscal sustainability (general government debt and deficit). As for financial factors, we employed, on the one hand, real and nominal stock market values and house prices and, on the other hand, credit to the private sector (loans to the private sector when available). Finally, we checked whether the length, the intensity and the time period in which the episode of strong money growth occurred had also a role in the determination of inflationary outcomes.

Table 5 reports the estimates of the basic model for the 71 episodes previously selected (see column 1). The signs of the coefficients of the real GDP growth and the interest rate are, as expected, positive and negative respectively, and both are significantly different from zero, while nominal and real measures of the exchange rate, current oil and commodity price levels and debt to GDP ratio are not significantly different from zero.¹³ The contribution of other asset prices in influencing the probability that a period of strong money growth is followed by an outburst of inflation is also broadly significant. Both the deviations of the stock market and

¹³ Nor did measures of inflation turn out to be significant explanatory variables. This is not surprising since the definition of “inflationary episode” does not depend on the level of inflation during the episode.

house prices from the trend turn out to be significantly positive. In addition, the credit gap also contributes positively to the inflationary outcome. As for the specific characteristics of the episode, the average size of the money gap increase during the episode (a measure of the magnitude of the episode) is significant, while the length of the excess money growth period is not.

Table 5 Results from probit regressions

	(1)	(2)	(3)	(4)	(5)
Constant	-1.1805 (1.4791)	-1.9419 (1.5963)	-1.6459 (1.6072)	-1.6529 (1.5342)	-2.6590 ** (1.2394)
Real GDP growth	0.8114 *** (0.2337)	1.0210 *** (0.2735)	0.8834 *** (0.3495)	0.8027 *** (0.3097)	0.8598 *** (0.3316)
Interest rate	-0.2096 * (0.1139)	-0.2916 ** (0.1469)	-0.2211 * (0.1243)	-0.1887 * (0.1191)	-0.1768 * (0.1100)
Credit gap	0.2663 ** (0.1061)	0.4004 *** (0.1293)	0.3667 *** (0.1446)	0.2994 *** (0.1042)	0.2026 ** (0.0939)
Real stock price gap	0.4018 *** (0.1253)	0.6430 *** (0.1467)	0.7814 *** (0.1997)	0.6525 *** (0.1412)	
Real house price gap	0.6435 ** (0.2737)	0.7506 ** (0.3336)	0.6188 ** (0.2951)	0.6460 ** (0.2331)	
Delta money gap	0.0594 * (0.0331)	0.1036 *** (0.0415)	0.1019 ** (0.0443)	0.0848 ** (0.0369)	0.0555 * (0.0307)
Dummy 1970s (D70)		2.9502 *** (1.1197)	4.9360 *** (1.5958)	3.4580 *** (1.0334)	4.3886 *** (1.0430)
Dummy 1980s (D80)		-1.2131 (0.7699)			
Credit gap*D70			-0.4051 (0.3103)		
Real stock price gap*D70			0.0367 (0.0401)		
Real house price gap*D70			0.0442 (0.2108)		
Real asset gap					0.6789 *** (0.2285)
McFadden R ²	0.553	0.643	0.651	0.622	0.627
LR p-value	0.000	0.000	0.000	0.000	0.000
Marginal coeff.	0.383	0.367	0.380	0.376	0.387
Total obs.	71	71	71	71	71
Dep=0	38	38	38	38	38
Dep=1	33	33	33	33	33

Note: Standard errors in parentheses. The symbols *, **, *** denote statistical significance at 10, 5 and 1 per cent.

We then checked whether there are differences between time periods. In particular, we considered three sub-samples (the 1970s, the 1980s and the 1990s, including the few episodes that occurred after 2000). A set of dummy variables suggests that there is indeed a higher probability of inflationary outburst in the 1970s (see column 2).

In order to check whether this higher probability has an impact also on other coefficients of the model, we introduced in the regressions a multiplicative dummy for each of the following variables: real stock price gap, real house price gap and credit gap (see column 3). It turns out that the coefficients are not significantly different from zero. This in turn implies that the model specification is the same across time periods and that stock market, house prices and credit dynamics exerted the same effects on the probability of inflation along the whole time span.

Table 6 Classification table (success cut-off $C=0.5$)

	Estimated Equation			Constant Probability		
	Dep=0	Dep=1	Total	Dep=0	Dep=1	Total
P(Dep=1) \leq C	32	5	37	38	33	71
P(Dep=1) $>$ C	6	28	34	0	0	0
Total	38	33	71	38	33	71
Correct	32	28	60	38	0	38
%Correct	84.21	84.85	84.51	100	0	53.52
%Incorrect	15.79	15.15	15.49	0	100	46.48
Total Gain*	-15.79	84.85	30.99			
Percent Gain**		84.85	66.67			

Notes:

* Change in “%Correct” from default (constant probability) specification.

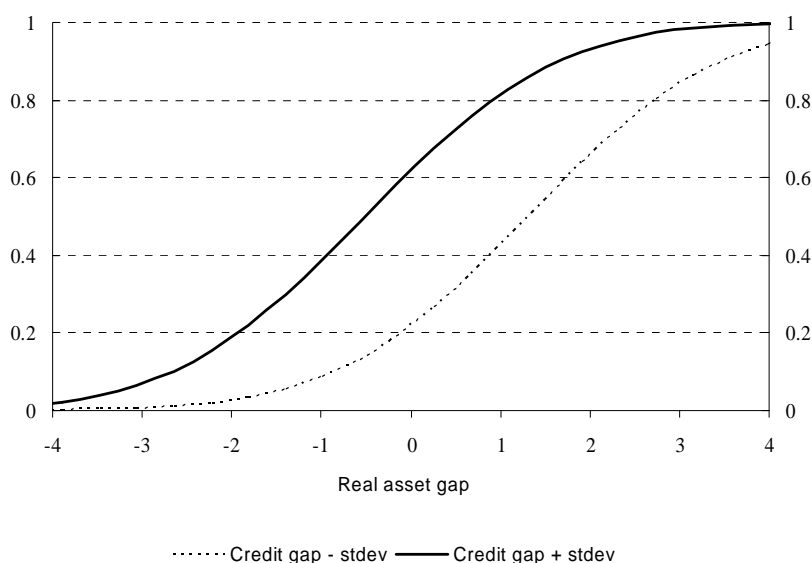
**Percentage of incorrect (default) predictions corrected by equation.

The predictive ability of the model is investigated via the “classification table” (see Table 6), which shows the number of “hits” and “misses” of the prediction rule. In this regard, the performance of the model is assessed on the basis of a bivariate indicator which assigns “1” to the dependent variable (“Dep”) if the estimated probability is larger than 0.5 and “0” otherwise. Overall, our model performs fairly well: in the event of an excess money growth episode, it correctly predicts around 85 per cent of both inflationary and non-inflationary outcomes. Only six times out of 34 is an inflationary outcome incorrectly signaled (i.e. it actually did not occur); and only five times out of 37 is a non-inflationary

outcome wrongly classified.¹⁴ Given that in terms of policy Type I errors (i.e. missing an inflationary outburst) are more relevant than Type II errors (i.e. calling a crisis that does not materialize), we can read the data in a different way. Notwithstanding a value as low as 17.6 for the “noise to signal ratio”, which is the share of wrong inflationary signals, the model is able to predict a large number of crises (84.8 per cent).

It should be noted, however, that the model is not meant as a predicting tool for inflation in a three-year horizon as we relied on the *ex post* knowledge of variable dynamics over the whole time horizon. A “truly” leading indicator could only be devised if trend measures could be updated in real time every quarter, taking into account only the information available at that point in time. In this respect, our method departs from the one used by Borio and Lowe (2004), who a) compute recursive type trends and gap measures up to each episode using, however, *ex post* (revised) data; and b) look at a list of financial distress dates which could not be, obviously, available *a priori*.

Figure 2 Probability of inflationary outcome



¹⁴ The right-hand side of Table 6 reports the relative performance of our model with respect to the naive rule which assigns “1” to the dependent variable if the proportion of 1 in the sample is larger than 0.5 and “0” otherwise. Overall, the total gain in using our model (measured by the difference between the percentage of corrected predictions from the model and those from the constant probability specification) is 31 percentage points (from 53.5% to 84.5%), which represents a relative improvement of 67%.

In order to investigate the joint effect of asset prices and credit dynamics, we constructed an aggregate gap measure just averaging the real stock and house price gaps. We then estimated the probit regression with this new variable (see column 5 of Table 5). Figure 2 depicts the evolution of the probability of an inflationary outburst with respect to the aggregated asset prices gap when the other explanatory variables are at their average levels and the dummy is set to zero.¹⁵

The dotted line is computed for a low level of the credit gap (the average value less the standard deviation), while the continuous line is associated to a higher level of the same variable (the average value plus the standard deviation). It is immediately clear that the effect of an increase in the asset gap is non-linear, but it is also evident that its relative contribution to the probability of an inflationary outburst depends on the level of the credit gap. In fact, when both variables are at low levels, an increase in the asset gap determines a relatively mild increase in the probability, while the same increase is significant when the credit gap is at a higher level. For instance, when the latter is one time the standard deviation below its long-term trend, a position of 1.5 per cent of the asset gap determines a probability of inflation still around 0.5, while the same position leads to a much larger probability (0.9) when the credit gap is above the trend.

This empirical evidence is in line with the reasoning put forward in Borio and Lowe (2002 and 2004), who suggest that the simultaneous violation of a given threshold in both variables represents the best proxy of the notion of financial imbalance. A rapid and sizeable increase in credit growth may not necessarily be a problem if the price of the assets backing that expansion grows at a sustainable rate. Similarly, booms and busts in asset prices do not necessarily cause great disruption if agents are not burdened by large debts and rigid liability commitments. Thus, in their opinion, the likelihood of financial disruption increases greatly only when the two developments occur at the same time. Figure 2 seems to fully support this view.

¹⁵ The real asset price gap ranges from -13 to 15; however, almost 2/3 of the observations occur between the values from -4 to 4 displayed in Figure 2.

However, we depart from Borio and Lowe (2004) in an important aspect. The two authors report three main findings: 1) an indicator made by a combination of credit and equity excessive growth is able to anticipate financial imbalances (i.e. banking distress) fairly well; 2) the same indicator shows some leading properties for a reduction in the inflation rate; 3) a positive money gap in excess of two per cent does lead to some upward pressure on inflation over a two-year horizon. Our results instead highlight that periods of significant imbalances in money growth shortly precede an inflationary increase when they are associated with a contemporaneous expansion of credit to the private sector and with asset prices being above their trend developments. In support of our interpretation, Detken and Smets (2004) and Helbling and Terrones (2003) in their analyses of asset price booms and busts find evidence that booms (in particular those followed by sharp reductions in the GDP growth rate) are accompanied by easy monetary and credit conditions and are also characterized by a subsequent large increase in the inflation gap. Similar results are obtained when starting from house market cycles (Catte et al., 2004; Ahearne et al., 2005; Van den Noord, 2006).

A theoretical background for the relationship between monetary aggregates, asset prices and inflation can be dated as back as Brunner and Meltzer (1973). They build on the traditional Keynesian liquidity effect to introduce a broader range of assets in the monetary policy transmission mechanism. Central bank operations that increase liquidity will have the price of assets rise almost step by step. Substitutions from more to less liquid assets take place as the return on more liquid instruments decreases relative to the less liquid and usually riskier assets. Thus, short-term government bonds should be affected relatively early, followed by longer-term securities, by other assets such as stocks and real estate, and finally by the overall price index. In this framework price pressure on stock markets is then seen as a possible warning of future price inflation.

The result that money and credit developments may contain useful information for forecasting price developments is also well established in the literature as well as in central banks' experience. On the one hand, it has been empirically shown that money and credit aggregates are characterized by additional information content for price developments beyond that contained in other macroeconomic indicators (Altissimo et al., 2001; Leeper and Roush, 2002; Nelson, 2003; Gerlach and Svensson, 2003). On the other hand, a large number of theoretical and empirical works emphasized the role of monetary and credit developments in

the transmission of monetary policy shocks and the determination of the price level (Bernanke and Gertler, 1995; Engert and Selody, 1998). For example, when bank credit is rationed via non-price mechanisms, monitoring credit aggregates helps to better understand the economic and financial outlook and the likely impact of monetary policy actions on price developments.¹⁶ Furthermore, a shock to the financial system which increases efficiency in the banking sector may reduce the cost of intermediation, thus making credit more readily available. This in turn leads to increasing demand and building inflationary pressures.

Summing up, we showed that following episodes of significant monetary growth inflation occurred fewer times than expected. In particular, a set of probit regressions suggests that inflationary pressures materialize only when the economy is growing at a fast rate, real rates are low and possible financial imbalances are gathering. This, in turn, leads us to conclude that, together with strong monetary growth, there should also be other “fundamental” factors at work for the occurrence of inflationary outbursts in the short run. This result is fully consistent with the large body of the empirical literature providing evidence that in the short run output gap measures and business cycle indicators are better suited to forecast inflation.¹⁷ The analysis of the joint development of the variables which turned out to be significant for the inflationary outcome is beyond the scope of this work, but it indeed represents a possible avenue for future research.

Our empirical results also suggest that large increases in monetary aggregates are less likely to be inflationary when output growth is subdued, real rates are high, other assets are not experiencing unjustified price rallies, and credit developments are along trend standards. In that case other reasons for the increased money growth have to be investigated, although they are less likely to lead to inflationary consequences. For instance, portfolio shift between assets may be the result of temporary changes in investors’ preference for safe and liquid assets included in broad monetary aggregates. This, in turn, may happen in periods of increasing financial market volatility and heightened economic and geopolitical uncertainty.

¹⁶ See the large body of the credit rationing literature which followed Stiglitz and Weiss (1981).

¹⁷ See Orphanides and Van Norden (2005), Banerjee et al. (2005) and Stock and Watson (2006) for some recent contributions.

5. Robustness analysis

In order to assess the robustness of our results we conducted several checks on both episode selection criterion and inflationary outcome definition. Concerning the selection technique, first, we adjusted the number of quarters needed to qualify an episode as a robust money growth phase; second, we augmented the average distance of the money-to-GDP ratio from its trend required to be considered in the sample. In particular, on the one hand, we looked at all episodes for which the positive deviation of the money gap lasted for at least three and five quarters, respectively, instead of the four quarters considered in the main analysis of the previous sections. With the looser criterion of three quarters we augmented the sample from 71 to 76 episodes, while the stricter rule of five consecutive quarters led to a reduction of the number of the episodes from 71 to 63.¹⁸ On the other hand, we adopted the much stronger criterion of two per cent for the average money gap trend deviation to qualify the period as an excessive money growth episode. The threshold of two per cent is the one used by Borio and Lowe (2004) in their analysis of the money gap behavior in periods of financial distress. Just 49 episodes of the 71 previously selected were able to pass this more restrictive condition. The share of the inflationary episodes did not change much in the first two new samples. In fact, the share is unchanged at 46 per cent for the three-quarter length rule, while it slightly increases to 49 per cent for the five-quarter rule. Only when using the Borio-Lowe criterion did the share breach the 50 per cent threshold (51 per cent). This latter value is in line with the previous finding that the larger the money gap the higher the probability of an inflationary outcome.

Concerning the criterion used to detect whether excessive money growth episodes were inflationary, we ran two different robustness tests. In particular, we checked whether the time window over which we evaluated inflationary developments did matter in the selection of inflationary periods. Since the aim of the paper is the short-run assessment of the relationship between money and price developments we shorten the reference horizon in two ways. First, we limited to two years (i.e. eight consecutive quarters) the period after the end of the episode

¹⁸ The additional five episodes selected by the three-quarter rule (two of which inflationary) are Canada 2001Q3-2002Q1, France 1984Q4-1985Q2, Japan 1994Q4-1995Q2, Netherlands 1986Q4-1995Q2 (inflationary) and USA 1998Q4-1999Q2 (inflationary). According to the five-quarter rule we instead dropped the eight episodes listed in Table 1 which lasted exactly four quarters.

available to detect the increase in inflation; second, while maintaining a three-year horizon for the *ex post* assessment, we started evaluating the price dynamics one year after the beginning of the episode. In other words, we compared price developments in the first four quarters of each episode with the following 12 quarters regardless of the length of money growth episode. Due to the fact that we have many episodes lasting more than three years, the latter check is meant to assess whether the transmission from money growth to inflation started before the end of the excessive money growth phase.

Table 7 Results from probit regressions

	base	3q	5q	2y	aly	m>2
Constant	-1.1805 (1.4791)	-1.4269 (1.3778)	-1.1069 (1.5397)	-1.7682 (1.3764)	3.3306 ** (1.7264)	-0.5004 (1.1766)
Real GDP growth	0.8114 *** (0.2337)	0.8211 *** (0.2325)	0.8670 *** (0.2580)	0.8881 *** (0.2511)	0.9864 *** (0.2824)	0.8650 *** (0.3316)
Interest rate	-0.2096 * (0.1139)	-0.1890 * (0.1059)	-0.1349 (0.1041)	-0.2431 ** (0.0959)	-0.6326 *** (0.1746)	-0.1114 * (0.0611)
Credit gap	0.2663 ** (0.1061)	0.2964 *** (0.1087)	0.2467 ** (0.1175)	0.3849 *** (0.1222)	0.7505 *** (0.2155)	0.2963 *** (0.1120)
Real stock price gap	0.4018 *** (0.1253)	0.4070 *** (0.1211)	0.3637 *** (0.1143)	0.3509 *** (0.1118)	0.8028 *** (0.1883)	0.3229 ** (0.1366)
Real house price gap	0.6435 ** (0.2737)	0.6744 *** (0.2644)	0.4919 * (0.2746)	0.4320 ** (0.2281)	0.3595 * (0.2371)	0.7857 ** (0.408)
Delta money gap	0.0594 * (0.0331)	0.0610 * (0.0337)	0.0672 ** (0.0329)	0.0182 (0.0512)	0.1699 ** (0.0712)	0.0511 * (0.0303)
McFadden R ²	0.553	0.535	0.533	0.525	0.685	0.512
Total obs	71	76	63	71	71	49
Dep=0	38	41	32	40	40	24
Dep=1	33	35	31	31	31	25
Inflationary Share	0.465	0.461	0.492	0.437	0.437	0.510
Marginal coeff.	0.383	0.381	0.397	0.370	0.210	0.396

Note: Standard errors in parentheses. The symbols *, **, *** denote statistical significance at 10, 5 and 1 per cent, respectively.

When considering the shorter eight-quarter period after the end of the money growth phase we recoded a switch of three episodes from inflationary to non-inflationary (namely, the first episode for Denmark, the third for Sweden and the sixth for the United States) and only a single one from non-inflationary to inflationary (the third for Italy). Broader changes were instead witnessed when employing a time window of three years starting from the fifth quarter of the money growth period: five episodes switched from inflationary to non-inflationary (the fifth episode for Canada, the third and fourth for Denmark, the second for

Italy and the third for New Zealand) and three episodes from non-inflationary to inflationary (the second episode for Canada, the fourth for Japan and the sixth for Sweden). Again the share of inflationary episodes did not change substantially: in both cases it fell by just two percentage points to 44 per cent.

Table 7 reports the estimates of the probit regressions on the new samples constructed as described above. The first column is the same as the one in Table 5 and it is included for the sake of comparison. In the second column the results of the regression based on the three consecutive quarter selection rule are reported. In the third column, the results related to the five consecutive quarter rule are shown. The fourth and the fifth columns report the results for the two-year window for the inflationary assessment and for the three-year window after the first year of money growth, respectively. Finally, in the sixth column we report the results stemming from the use of the Borio-Lowe money gap rule.

For all samples the coefficients maintained the expected sign and the magnitude changed substantially only for the coefficients of the three-year window after the first year of money growth.¹⁹ In addition, only twice were the coefficients not significantly different from zero. Thus, the overall assessment of Section 4 is entirely confirmed. Both real stock and house prices increase the probability of turning an episode of robust money growth into an inflationary outburst. Similarly, the likelihood is greater when the economy is booming and when credit to the private sector is loose. Also the positive sign of the coefficient on the nominal money gap confirms that the magnitude of the deviation from trend behavior does matter in influencing the transmission to inflation. Finally, the negative sign on short-term real interest rates shows that higher rates are associated with a lower probability of inflation.

¹⁹ However, note that since probit regressions are non-linear in nature, the direct effect of each variable on the probability of an inflationary outcome is to be obtained through the marginal coefficient (last line of Table 7), which is significantly smaller in the case of the regression concerning the three-year window after the first year of money growth than in the other samples. For a discussion on the role of marginal coefficients and their exact computation see, for instance, Greene (2003).

6. Conclusions

We investigated the short-run consequences of periods of strong monetary growth for inflation dynamics in 15 industrial economies. As a first step, we detected 71 episodes of prolonged money growth above trend values over the last three decades. We then checked in how many cases the inflation gap increased significantly over a three-year horizon. We found that in less than 50 per cent of all cases strong monetary dynamics were followed by price developments that can be labeled inflationary. Even if this result is striking considering that we focused only on periods of abnormal money growth for which we expected a much higher correlation with prices, it is consistent with the view that in the short run the quantity theory does not always hold due to the circumstance that other factors might temporarily affect price dynamics.

As a further step we extended the analysis by considering whether the evolution of various macroeconomic and financial variables during the excess money growth episodes can help predict inflation. The results from an econometric investigation based on probit regressions suggest that developments in other asset prices and credit conditions do help identify price dynamics over a three-year horizon. When the excessive money growth is accompanied by large increases in stock prices, house prices and loose credit conditions, the probability of recording an inflationary outcome rises significantly. In addition, it appears that the relationship is non-linear. A rise in one of the two indicators of asset prices and credit conditions is associated with a strong increase in the probability of recording inflation only when the other is already at high levels. Even large increases in one of the two variables do not lead to a worrying increase in the probability when the other is below trend values.

From a policy perspective, our analysis suggests that when money growth is accompanied by loose credit conditions and sustained asset prices growth, it seems to be “more fundamental” in nature and more likely to lead to inflationary pressures. Conversely, when strong monetary dynamics are not accompanied by high credit growth and strong dynamics in asset prices, other determinants seem to affect monetary developments, which are not necessarily linked to inflationary consequences.

A note of caution is needed in interpreting our results. In our analysis the role of monetary policy is not explicitly considered. A central bank may react to an excessive

increase in monetary aggregates, thereby changing the contemporaneous and subsequent behavior of other macroeconomic and financial variables. Such responses might have been different not only across time but also across countries. However, a possible assessment of the monetary policy stance during the selected money growth phases can be extracted from the different magnitude of interest rates. A preliminary analysis based on the ANOVA test has shown that the levels of both real and nominal rates for both short- and long-term maturities were lower during inflationary episodes than in non-inflationary episodes. In addition, the econometric specification has detected a significant negative contribution of real short-term interest rates for the probability of incurring an increase in inflation (i.e. the higher the rates the lower the probability of inflation). Thus, even though we did not test the correctness of the monetary policy stance in each country and period, for instance through a Taylor rule, the evidence gathered suggests that the stance was relatively loose during the episodes of excess money growth that were followed by an outburst of inflation. In contrast, the higher levels of interest rates during the episodes that were not followed by an increase in inflation hints at a tighter policy stance, which may have contributed to maintain price stability.

Appendix

Description of the data and their sources

This appendix contains additional information about the series used in our analysis. In order to save space, we present them in a table format. The main sources for the series were: BIS, Datastream, Euro area wide model (AWM), Eurostat, Global Financial Data, IMF International Financial Statistics (abbreviated as IMF), the respective National Central Banks for each country, OECD Main Economic Indicators (abbreviated as OECD) and Reuters. All data are seasonally adjusted (with the exception of interest rates, exchange rates and the stock market index) either from the original source (whenever available) or via the multiplicative (ratio to moving average) method. Sources are reported in italics below each series to which they refer.

		Australia	Canada	Denmark	Euro area
Inflation rate	<i>Definition</i>	year-on-year changes in the CPI - all items (base year = 1990)	year-on-year changes in the CPI - all items (base year = 1992)	year-on-year changes in the HICP, before 1992 based on the rates of change of CPI (excluding owner occupied housing)	year-on-year changes in the HICP, before 1992 based on the rates of change of national CPIs (excluding owner occupied housing, except for Spain)
	<i>Source</i>	Reserve Bank of Australia	BIS	ECB, Eurostat	ECB, Eurostat
Nominal GDP	<i>Definition</i>	gross domestic product at current prices	gross domestic product at market prices (current prices, including 2001 revisions)	gross domestic product at market prices (current prices)	gross domestic product at current prices, based on aggregating national GDP data using the irrevocable fixed exchange rates
	<i>Source</i>	Reserve Bank of Australia	BIS	Eurostat, Global Financial Data	Area wide model, ECB, Eurostat
Real GDP	<i>Definition</i>	gross domestic product at constant prices, chain volume measure	gross domestic product at market prices - chained 1997	gross domestic product at market prices (constant 1995 prices)	gross domestic product at market prices (constant 1995 prices), based on aggregating national GDP data using the irrevocable fixed exchange rates
	<i>Source</i>	Reserve Bank of Australia	BIS	Eurostat, Global Financial data	Area wide model, ECB, Eurostat
Investment	<i>Definition</i>	investment, gross fixed capital formation (SNA 93), current prices	investment, gross fixed capital formation, total (including 2001 revisions), current prices	investment, gross fixed capital formation, current prices	investment, gross fixed capital formation, current prices
	<i>Source</i>	BIS	BIS, IMF	Eurostat	AWM, Eurostat
Monetary aggregates	<i>Definition</i>	M3 stock (adjusted)	M3 (currency plus total privately-held chartered bank deposits)	M3 stock	M3 stock (adjusted after October 1997 for the effect of reclassifications, other revaluations, exchange rate variations and the enlargement in 2001)
	<i>Source</i>	Reserve Bank of Australia	BIS	OECD	ECB calculations, ECB
Credit aggregates	<i>Definition</i>	credit to the private sector	credit to the private sector	credit to the private sector	loans to the private sector stock (adjusted after October 1997 for the effect of reclassifications, other revaluations and exchange rate variations and the enlargement in 2001)
	<i>Source</i>	IMF, Reserve Bank of New Zealand	OECD	BIS, OECD	ECB, ECB calculations
Stock market prices	<i>Definition</i>	stock exchange prices, shares, overall index	S&P/TSX composite price index	KAX CSE all shares index	DJ Euto Stoxx 50 price index and, before 1987, share index covering a set of stocks representing 75%-80% of the total market capitalisation
	<i>Source</i>	BIS, Global Financial Data	Datastream	Global Financial data, OECD	Datastream, Reuters

		Australia	Canada	Denmark	Euro area
House prices	<i>Definition</i>	residential property prices	residential property prices	residential property prices	residential property prices
	<i>Source</i>	<i>BIS, Reserve Bank of Australia</i>	<i>BIS</i>	<i>BIS, Eurostat</i>	<i>ECB, ECB calculations, Eurostat</i>
Short-term interest rate	<i>Definition</i>	3-months bank accepted bills	money market interest rate, 3-months treasury bills	3-months money market interest rate (before 1982 call money rate)	EURIBOR, before 1999 weighted average of national 3-month money market interest rates, based on 2004 GDP weights at PPP exchange rates
	<i>Source</i>	<i>Reserve Bank of Australia</i>	<i>BIS</i>	<i>BIS, IMF</i>	<i>BIS, Reuters</i>
Long-term interest rate	<i>Definition</i>	10-year treasury bonds yield	10-year government bonds yield (before 1989 yielded on government bonds with maturity more than 10 years)	10-year government bond yield	weighted average of national 10-year government bond yields, based on 2004 GDP weights at PPP exchange rates
	<i>Source</i>	<i>BIS</i>	<i>BIS, IMF</i>	<i>BIS, IMF</i>	
Nominal effective exchange rate	<i>Definition</i>	nominal effective exchange rate, Australian dollar, based on currencies covering at least 90% of Australia's trade	nominal effective exchange rate	nominal effective exchange rate	nominal effective exchange rate, euro, broad index (euro area 12)
	<i>Source</i>	<i>BIS, Reserve Bank of Australia</i>	<i>BIS</i>	<i>IMF</i>	<i>BIS, ECB</i>
Real effective exchange rate	<i>Definition</i>	real effective exchange rate, Australian dollar, 1990=100	real effective exchange rate, Canadian dollar, 1990=100	real effective exchange rate, Danish Kroner, 1990=100	real effective exchange rate, euro, 1990=100
	<i>Source</i>	<i>BIS</i>	<i>BIS</i>	<i>BIS</i>	<i>BIS</i>
Debt	<i>Definition</i>	government debt (as a percentage of nominal GDP)	gross federal government debt (as a percentage of nominal GDP)	general government consolidated gross debt Excessive deficit procedure (based on ESA 1995) and former definition (linked series) (as a percentage of nominal GDP)	general government consolidated gross debt Excessive deficit procedure (based on ESA 1995) and former definition (linked series) (as a percentage of nominal GDP)
	<i>Source</i>	<i>BIS, IMF</i>	<i>Bank of Canada, IMF</i>	<i>European Commission</i>	<i>European Commission</i>
Deficit	<i>Definition</i>	general government deficit (as a percentage of nominal GDP)	net lending (+) or net borrowing (-); general government Excessive deficit procedure (as a percentage of nominal GDP)	net lending (+) or net borrowing (-); general government Excessive deficit procedure (as a percentage of nominal GDP)	net lending (+) or net borrowing (-); general government Excessive deficit procedure (as a percentage of nominal GDP)

		France	Germany	Italy	Japan
Inflation rate	<i>Definition</i>	year-on-year changes in the HICP, before 1992 based on the rates of change of CPI (excluding owner occupied housing)	year-on-year changes in the HICP, before 1992 based on the rates of change of CPI (excluding owner occupied housing)	year-on-year changes in the HICP, before 1992 based on the rates of change of CPI (excluding owner occupied housing)	year-on-year changes in the CPI - all items (whole country)
	<i>Source</i>	ECB, Eurostat	ECB, Eurostat	ECB, Eurostat	BIS
Nominal GDP	<i>Definition</i>	gross domestic product at market prices (current prices, ESA 95)	gross domestic product at market prices (current prices, ESA 95)	gross domestic product at market prices (current prices, ESA 95)	gross domestic product at market prices (current prices, SNA 93)
	<i>Source</i>	ECB, Eurostat, IMF	ECB, Eurostat, IMF	ECB, Eurostat, IMF	BIS, IMF
Real GDP	<i>Definition</i>	gross domestic product at market prices (constant 1995 prices)	gross domestic product at market prices (constant 1995 prices)	gross domestic product at market prices (constant 1995 prices)	gross domestic product at market prices (constant 2000 prices, chained, SNA 93)
	<i>Source</i>	ECB, Eurostat, IMF	ECB, Eurostat, IMF	ECB, Eurostat, IMF	BIS, IMF
Investment	<i>Definition</i>	investment, gross fixed capital formation, current prices	investment, gross fixed capital formation, current prices	investment, gross fixed capital formation, current prices	investment, gross fixed capital formation (SNA 93), current prices
	<i>Source</i>	Eurostat, IMF	Eurostat, IMF	Eurostat, IMF	BIS, IMF
Monetary aggregates	<i>Definition</i>	M3 stock (adjusted after October 1997 for the effect of reclassifications, other revaluations and exchange rate variations)	M3 stock (adjusted after October 1997 for the effect of reclassifications, other revaluations and exchange rate variations)	M3 stock (adjusted after October 1997 for the effect of reclassifications, other revaluations and exchange rate variations)	M2 + certificates of deposits (CDs) stock
	<i>Source</i>	ECB calculations, ECB	ECB calculations, ECB	ECB calculations, ECB	BIS
Credit aggregates	<i>Definition</i>	loans to the private sector stock (adjusted after October 1997 for the effect of reclassifications, other revaluations and exchange rate variations)	loans to the private sector stock (adjusted after October 1997 for the effect of reclassifications, other revaluations and exchange rate variations)	loans to the private sector stock (adjusted after October 1997 for the effect of reclassifications, other revaluations and exchange rate variations)	credit to the private sector by domestically licensed banks
	<i>Source</i>	ECB, ECB calculations	ECB, ECB calculations	ECB, ECB calculations	OECD
Stock market prices	<i>Definition</i>	CAC 40 shares price index and, before 1988, CAC general index	CDAX total share price index	share overall price index (MIB) and, before 1974, BCI general index	Nikkei 225 stock exchange prices index
	<i>Source</i>	BIS, Global Financial Data	BIS, Global Financial Data	BIS, Global Financial Data	BIS

		France	Germany	Italy	Japan
House prices	<i>Definition</i>	residential property prices	residential property prices	residential property prices	residential property prices
	<i>Source</i>	<i>ECB, Government Agency</i>	<i>ECB</i>	<i>ECB</i>	<i>BIS, Bank of Japan</i>
Short-term interest rate	<i>Definition</i>	3-month money market interest rates	3-month money market interest rates	3-month money market interest rates (before 1974 3-month treasury bills)	3-month repos on bonds - Gensaki - (before 1979 call money rate)
	<i>Source</i>	<i>Reuters</i>	<i>Reuters</i>	<i>Global Financial Data, Reuters</i>	<i>BIS, IMF</i>
Long-term interest rate	<i>Definition</i>	10-year government bonds yield	10-year public sector bonds yield	10-year government bonds yield	10-year government bond yield
	<i>Source</i>	<i>BIS</i>	<i>BIS</i>	<i>BIS</i>	<i>BIS, IMF</i>
Nominal effective exchange rate	<i>Definition</i>	nominal effective exchange rate	nominal effective exchange rate	nominal effective exchange rate	nominal effective exchange rate, yen
	<i>Source</i>	<i>IMF</i>	<i>IMF</i>	<i>IMF</i>	<i>BIS, Bank of Japan</i>
Real effective exchange rate	<i>Definition</i>	real effective exchange rate	real effective exchange rate	real effective exchange rate	real effective exchange rate, Japanese yen, 1990=100
	<i>Source</i>	<i>IMF</i>	<i>IMF</i>	<i>Banca d'Italia, IMF</i>	<i>BIS</i>
Debt	<i>Definition</i>	general government consolidated gross debt Excessive deficit procedure (based on ESA 1995) and former definition (linked series) (as a percentage of nominal GDP)	general government consolidated gross debt Excessive deficit procedure (based on ESA 1995) and former definition (linked series) (as a percentage of nominal GDP)	general government consolidated gross debt Excessive deficit procedure (based on ESA 1995) and former definition (linked series) (as a percentage of nominal GDP)	general government consolidated gross debt Excessive deficit procedure (based on ESA 1995) and former definition (linked series) (as a percentage of nominal GDP)
	<i>Source</i>	<i>European Commission</i>	<i>European Commission</i>	<i>European Commission</i>	<i>European Commission</i>
Deficit	<i>Definition</i>	net lending (+) or net borrowing (-); general government Excessive deficit procedure (as a percentage of nominal GDP)	net lending (+) or net borrowing (-); general government Excessive deficit procedure (as a percentage of nominal GDP)	net lending (+) or net borrowing (-); general government Excessive deficit procedure (as a percentage of nominal GDP)	net lending (+) or net borrowing (-); general government Excessive deficit procedure (as a percentage of nominal GDP)

		Netherlands	New Zealand	Norway	Spain
Inflation rate	<i>Definition</i>	year-on-year changes in the HICP, before 1992 based on the rates of change of CPI (excluding owner occupied housing)	year-on-year changes in the CPI - all items	year-on-year changes in the CPI - all items	year-on-year changes in the HICP, before 1992 based on the rates of change of CPI
	<i>Source</i>	ECB, Eurostat	Reserve Bank of New Zealand	BIS	ECB, Eurostat
Nominal GDP	<i>Definition</i>	gross domestic product at market prices (current prices, ESA 95)	gross domestic product at market prices (current prices)	gross domestic product at market prices (current prices)	gross domestic product at market prices (current prices, ESA 95)
	<i>Source</i>	ECB, Eurostat, IMF	Global Financial Data, IMF	IMF	ECB, Eurostat, IMF
Real GDP	<i>Definition</i>	gross domestic product at market prices (constant 1995 prices)	gross domestic product at market prices (constant 1995/96 prices, chained, SNA 93)	gross domestic product at market prices (constant 2001 prices)	gross domestic product at market prices (constant 1995 prices)
	<i>Source</i>	ECB, Eurostat, IMF	BIS, Global Financial Data, IMF	IMF	ECB, Eurostat, IMF
Investment	<i>Definition</i>	investment, gross fixed capital formation, current prices	investment, gross fixed capital formation (SNA 93), current prices	investment, gross fixed capital formation, total (ESA 95), current prices	investment, gross fixed capital formation, current prices
	<i>Source</i>	Eurostat	BIS, IMF, Reserve Bank of New Zealand	Eurostat, IMF	Eurostat, IMF
Monetary aggregates	<i>Definition</i>	M3 stock (adjusted after October 1997 for the effect of reclassifications, other revaluations and exchange rate variations)	M3 stock	M2 stock	M3 stock (adjusted after October 1997 for the effect of reclassifications, other revaluations and exchange rate variations)
	<i>Source</i>	ECB calculations, ECB	OECD	OECD	ECB calculations, ECB
Credit aggregates	<i>Definition</i>	loans to the private sector stock (adjusted after October 1997 for the effect of reclassifications, other revaluations and exchange rate variations)	credit to the private sector	credit by all financial institutions	loans to the private sector stock (adjusted after October 1997 for the effect of reclassifications, other revaluations and exchange rate variations)
	<i>Source</i>	ECB, ECB calculations	OECD, Reserve Bank of New Zealand	OECD	ECB, ECB calculations
Stock market prices	<i>Definition</i>	stock exchange all shares price index	NZSE All shares Capital index	OSE Total TOTX share prices index	shares overall price index and, before 1985, Madrid general index
	<i>Source</i>	BIS, Global Financial Data	OECD	Global Financial data, OECD	BIS, Global Financial Data

		Netherlands	New Zealand	Norway	Spain
House prices	<i>Definition</i>	residential property prices	residential property prices	residential property prices	residential property prices
	<i>Source</i>	<i>ECB</i>	<i>BIS, Reserve Bank of New Zealand</i>	<i>BIS, Statistics Norway</i>	<i>ECB</i>
Short-term interest rate	<i>Definition</i>	3-month money market interest rates (before 1972 3-month treasury bills)	3-month bank bills yield	3-month money market interest rates - Nibor - (before 1978 call money rate)	3-month money market interest rates
	<i>Source</i>	<i>Reuters</i>	<i>OECD</i>		<i>Reuters</i>
Long-term interest rate	<i>Definition</i>	10-year government bond yield	10-year government bond yield	10-year government bond yield	10-year government bonds yield (before 1977 10-year government bonds yield)
	<i>Source</i>	<i>BIS, IMF</i>	<i>BIS, IMF</i>	<i>BIS, IMF</i>	<i>BIS, Global Financial Data</i>
Nominal effective exchange rate	<i>Definition</i>	nominal effective exchange rate	nominal effective exchange rate calculated on the basis of representative market rates for the currencies in the basket	nominal effective exchange rate	nominal effective exchange rate
	<i>Source</i>	<i>IMF</i>	<i>BIS, Reserve Bank of New Zealand</i>	<i>IMF</i>	<i>IMF</i>
Real effective exchange rate	<i>Definition</i>	real effective exchange rate	real effective exchange rate, New Zealand dollar, 1990=100	real effective exchange rate, Norwegian Kroner, 1990=100	real effective exchange rate
	<i>Source</i>	<i>IMF</i>	<i>BIS</i>	<i>BIS</i>	<i>IMF</i>
Debt	<i>Definition</i>	general government consolidated gross debt Excessive deficit procedure (based on ESA 1995) and former definition (linked series)(as a percentage of nominal GDP)	public government debt (as a percentage of nominal GDP)	government debt (as a percentage of nominal GDP)	general government consolidated gross debt Excessive deficit procedure (based on ESA 1995) and former definition (linked series) (as a percentage of nominal GDP)
	<i>Source</i>	<i>European Commission</i>	<i>Global Financial Data, IMF, Reserve Bank of New Zealand</i>	<i>European Commission, IMF, OECD</i>	<i>European Commission</i>
Deficit	<i>Definition</i>	net lending (+) or net borrowing (-); general government Excessive deficit procedure (as a percentage of nominal GDP)	government deficit (-) or surplus	net lending (+) or net borrowing (-); general government Excessive deficit procedure (as a percentage of nominal GDP)	net lending (+) or net borrowing (-); general government Excessive deficit procedure (as a percentage of nominal GDP)

		Sweden	Switzerland	United Kingdom	United States
Inflation rate	<i>Definition</i>	year-on-year changes in the HICP, before 1992 based on the rates of change of CPI (excluding owner occupied housing)	year-on-year changes in the CPI - all items (base year = 2000)	year-on-year change in the retail prices index - all items	year-on-year changes in the CPI - all items (all urban consumers)
	<i>Source</i>	ECB, Eurostat	OECD	UK Office for National Statistics	BIS
Nominal GDP	<i>Definition</i>	gross domestic product at market prices (current prices)	gross domestic product at market prices (current prices, ESA 95)	Gross domestic product at market prices (current prices)	gross domestic product at market prices (current prices, including 1999 revisions)
	<i>Source</i>	Eurostat, Global financial data	BIS, IMF	Eurostat	BIS
Real GDP	<i>Definition</i>	gross domestic product at market prices (constant 1995 prices)	gross domestic product at market prices (ESA 95, constant 2000 prices, chained)	gross domestic product at market prices (constant 1995 prices)	gross domestic product at market prices (constant 2000 prices, chained)
	<i>Source</i>	Eurostat, Global Financial Data	BIS, IMF	Eurostat	BIS
Investment	<i>Definition</i>	investment, gross fixed capital formation, current prices	investment, gross fixed capital formation, total (ESA 95), current prices	investment, gross fixed capital formation, current prices	investment, gross fixed capital formation, total, current prices
	<i>Source</i>	Eurostat	BIS, IMF	Eurostat	BIS
Monetary aggregates	<i>Definition</i>	M3 stock	M3 stock	M4 stock	M2 (M1 plus small time and saving deposits and money market funds)
	<i>Source</i>	OECD	OECD	OECD	BIS
Credit aggregates	<i>Definition</i>	credit to the private sector	credit to the private sector	loans to the private sector	commercial bank credit
	<i>Source</i>	BIS, IMF	IMF, OECD	Bank of England	OECD
Stock market prices	<i>Definition</i>	shares overall index (SAX) and, before 1996, share prices AFGX index	UBS 100 share price index	FTSE 100 - price index	S&P 500 composite price index
	<i>Source</i>	BIS, OECD	OECD	Global Financial Data, Reuters	Reuters

		Sweden	Switzerland	United Kingdom	United States
House prices	<i>Definition</i>	residential property prices	residential property prices	residential property prices	residential property prices
	<i>Source</i>	<i>BIS, Statistics Sweden</i>	<i>BIS, OECD, Swiss National Bank</i>	<i>Communities and Local Government (DCLG), UK Office for National Statistics</i>	<i>BIS, Office of Federal Housing Enterprise Oversight (OFHEO)</i>
Short-term interest rate	<i>Definition</i>	3-month treasury bills yield	3-months money market interest rate (before 1974 discount rate)	3-month sterling interbank deposits interest rate (before 1977 treasury bill interest rate)	3-month money market treasury bills interest rates
	<i>Source</i>	<i>Global Financial data, OECD</i>	<i>IMF, OECD</i>	<i>BIS, IMF</i>	<i>BIS</i>
Long-term interest rate	<i>Definition</i>	10-year government bond yield	10-year government bond yield	10-year government bond yield	10-year government bond yield (before 1966 10-year treasury bonds yield)
	<i>Source</i>	<i>BIS, IMF</i>	<i>IMF</i>	<i>BIS, IMF</i>	<i>BIS, Reuters</i>
Nominal effective exchange rate	<i>Definition</i>	nominal effective exchange rate	nominal effective exchange rate	nominal effective exchange rate, broad index	nominal effective exchange rate, broad index, weighted average of the foreign exchange value of the US dollar against the currencies of a broad group of US trading partners
	<i>Source</i>	<i>IMF</i>	<i>BIS</i>	<i>BIS</i>	<i>BIS, FED</i>
Real effective exchange rate	<i>Definition</i>	real effective exchange rate, Swedish Kronor, 1990=100	real effective exchange rate, Swiss franc, 1990=100	real effective exchange rate, Sterling pound, 1990=100	real effective exchange rate, US dollar, 1990=100
	<i>Source</i>	<i>BIS</i>	<i>BIS</i>	<i>BIS</i>	<i>BIS</i>
Debt	<i>Definition</i>	general government consolidated gross debt Excessive deficit procedure (based on ESA 1995) and former definition (linked series) (as a percentage of nominal GDP)	total government debt (as a percentage of nominal GDP)	general government consolidated gross debt Excessive deficit procedure (based on ESA 1995) and former definition (linked series) (as a percentage of nominal GDP)	general government consolidated gross debt Excessive deficit procedure (based on ESA 1995) and former definition (linked series) (as a percentage of nominal GDP)
	<i>Source</i>	<i>European Commission</i>	<i>BIS, IMF</i>	<i>European Commission</i>	<i>European Commission</i>
Deficit	<i>Definition</i>		net lending (+) or net borrowing (-); general government Excessive deficit procedure (as a percentage of nominal GDP)	net lending (+) or net borrowing (-); general government Excessive deficit procedure (as a percentage of nominal GDP)	net lending (+) or net borrowing (-); general government Excessive deficit procedure (as a percentage of nominal GDP)

Notes: sources are reported in italics. To backdate a series, the growth rates of the longer available series further back in the past are used.

¹For the BIS source of house price series see the paper “What drives housing price dynamics: cross-country evidence”, by K. Tsatsaronis and H. Zhu.

²For more information on the construction of M3 and GDP series for the euro area, see the ECB Occasional Paper no. 3 “Estimating the trend of M3 income velocity underlying the reference value for monetary growth”, by Claus Brand, Dieter Gerdesmeier and Barbara Roffia, May 2002.

³For more information on the AWM dataset, see the ECB Working Paper no. 42 “An area-wide model (AWM) for the euro area”, by Gabriel Fagan, Jérôme Henry and Ricardo Mestre, January 2001.

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