

ABSTRACT FORM

for 2015 Japan Society of Monetary Economics Conference

Paper title	<b>Implicit Coordination of Interest Rate, Money, and Government Spending for GDP</b>
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Abstract	<p>A desirable goal of an economy management is to pursue economic growth with price stabilization through monetary policy and fiscal policy. Since the 2008 financial crisis, most countries have been using large scale government spending as a crisis remedy. Essentially, government spending is used to sustain the economy by creating demand when demand is insufficient. However this positive effect of government spending can cause instability in the financial market in the case of excessive government spending, underscoring the coordination of monetary and fiscal policy.</p> <p>A large number of researches regarding the coordination of between the monetary and the fiscal policy, however, reported that the policy-mix was not effective as expected. Blinder (1983) showed that I) monetary and fiscal authorities set different policy targets, ii) each authority has different viewpoints on the policy effects based on different economic theories, or iii) each authority has different forecasts for the future economy.</p> <p>This paper examines the monetary and fiscal policy coordination in the Korean economy by empirically investigating the implicit coordination among policy instrument variables, including the interest rate, money supply, and</p>

government spending, for the policy targets of GDP and consumer prices.

The results are as follows: first, Granger causality tests by ordinary least squares (OLS) and **vector autoregression** (VAR), using stationary first-differenced variables, showed no clear causal relations between the interest rate, money supply, and government spending and the GDP or consumer prices.

Second, a co-integration analysis identified a co-integrated relationship between the policy instrument variables and GDP, yet no co-integrated relationship with consumer prices.

Third, a Vector Error Correction Model (VECM) of the interest rate, money supply, government spending, and GDP revealed: i) the interest rate had short- run causal effects on GDP, ii) government spending had both short- run and long- run causal effects on GDP, and iii) the money supply had long- run causal effects on GDP. Plus, government spending had stronger short-run causal effects than the interest rate, while the money supply had greater long-run causal effects than government spending.

Fourth, a forecast error variance decomposition depicted the VECM results more clearly:

i) the influence of the interest rate on GDP was less than 1% for each forecast step.

ii) changes in money supply explained the change in GDP up to 4% after 12 steps.

iii) changes in government spending explained the change in GDP up to 10% after 12 steps, indicating that government spending had greater long-run causal effects on GDP than the money supply, which differed from the VECM results.

In summary, while no clear policy mix was identified among the instrument variables, the policy coordination of these instrument variables was found to have an implicit causal effect on GDP. In contrast, no implicit relationship was found

	<p>between the instrument variables and consumer prices, indicating consumer price is not much affected by demand-pull variables by cost -push factors.</p>
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