The Behavior of Money and Other Economic Variables: Two Natural Experiments

James R. Lothian and Cornelia H. McCarthy

A b s t r a c t: The object of this paper is to test the performance of the quantity-theory model and the related proposition of monetary neutrality in a context in which, to use Bernanke's phraseology, ''money move[d] for reasons that [were] plausibly unrelated to the current state of the economy.'' We investigate this question using data from two recent episodes of monetary-policy regime change – the move to floating exchange rates throughout the industrialized world following the breakdown of Bretton Woods in the early 1970s and the shift toward less expansive monetary policy that to varying degrees took place in these countries a decade or so later. The results of this exercise are highly positive. The money-price relationship that we observe is fully consistent with theory – growth shifts in the nominal stock of money and in the price level are highly correlated and bear a one-to-one relation to one another. Growth shifts in exchange rates are significantly related both to growth shifts in relative price levels and to growth shifts in relative excess supplies of money. The classical neutrality proposition – in this context superneutrality – in general, receives strong, though not totally unambiguous, support.

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