A MODELING PROCESS WITH EQUILIBRIUM AND POTENTIAL VARIABLES: THE CASE OF REAL MONEY DEMAND IN MOROCCO

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ABSTRACT:

The tradition in monetary economics is often to examine and estimate a function of real demand for money where the endogenous variable as well as explanatory factors are those effectively observed in the real world even with some measurement errors. The present paper takes a different direction, trying to work not on the real-world observed variables but on equilibrium and potential time-series, with the adoption of seemingly innovative approaches of measurement and econometric analysis.

In line with the existing theoretical predictions, economists often model the real demand for money as a function of real output and real interest rate. Nevertheless, even with a likely weak risk of colinearity, it is possible to model the behavior of real demand for money as depending upon a measure of real output as well as inflation and real interest rates.

In this paper, we adopt multiple approaches to measure the mentioned variables, with efforts to estimate a function of real demand for money in Morocco, in equilibrium and potential terms. The ultimate objective is to appreciate if the magnitude in the instability of the function dies out with the use of equilibrium and potential time series. *In fine*, the assessment of the relative stability of the real money demand function may be useful in macroeconomic policy terms, especially with respect to inflation targeting, as theoretically and empirically explored in a wide range in the recent literature.

The remainder of the paper is organized as follows. Section 2 presents a summarized literature on the issue. Section 3 outlines our research hypotheses together with objectives and expected results. Section 4 explains the methodological framework as devoted to empirical validations of our testable hypotheses. Section 5 presents and interprets our empirical results. Finally, section 6, together with concluding remarks, formulates some policy implications with respect to macroeconomic policies, especially monetary policy and inflation targeting.

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