Title: Money Supply Endogeneity: An Analysis of a Small Open Economy

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Abstract

In much of the mainstream macroeconomic literature the money supply is assumed to be exogenously determined by the central bank, using monetarist arguments. It is equal to the money multiplier times the monetary base and, since the central bank can change this base, it can control the supply of money. On the other hand, Post Keynesian economics argues that the money supply is endogenous. While there are a number of different explanations of money supply endogeneity, the core argument is that bank lending creates deposits and, therefore, money. This endogenous money hypothesis has been tested in a number of studies, but most of these have focussed on the larger developed economies. To develop more understanding of the relationship, it is vital that the research should be extended to cover the experience of other countries.

This study contributes to the debate by providing an empirical analyse of the Turkish case. Turkey presents a particularly interesting case study as it has run high public sector deficits, which have been accompanied by high inflation for a prolonged period, and as in Turkey banks hold more than 90 percent of the government borrowing instruments. To provide an empirical analysis, the cointegrating VAR method is employed with quarterly data on the different monetary aggregates, money multipliers, credits, and nominal income, and the long run relations in the data and the short run dynamics are estimated. Granger causality tests are undertaken, taking into account the cointegrating relations, and the implications for the endogenous money supply hypothesis are discussed.