ABSTRACT

A stable demand for money function is a necessary condition for the supply of money to be utilized as an instrument of monetary policy because effectiveness of monetary policy for overcoming economic fluctuations is the main objective of policy makers. This study uses the dynamic panel data methods to estimate cointegrating equation for the money demand (M1) for the panel of 74 developing countries from 1990 to 2011. Empirical findings show that demand or money is positively related to income, inflation CPI and exchange rate but negatively related to interest rate and deposit rate. The main findings are that real narrow money is cointegrated with its determinants and money demand function is found to be unstable. The effects of financial reforms are analyzed with structural break test and a single break date is found to be effective. The financial reforms are yet to have any significant effects in the developing countries. Since there is instability in the money demand function, so the central banks of these countries should reconsider their choice of monetary policy instrument for the implementation of an optimal monetary policy.