

**Comments on: "Wealth and the demand for money in the European Union"
by Martin M. G. Fase and Carlo C. A. Winder**

by Benjamin H. Cohen

It has been reported that monetary targeting is among the policy procedures being considered for the new European central bank. If this is the case, then stable, reliable models of Europe-wide money demand will certainly be needed. In view of the breakdowns in the relationships between money and nominal variables that have been observed in the US and elsewhere, one might have grounds for scepticism regarding whether such models can be found for Europe.

This paper addresses these concerns by presenting plausible error-correction models for quarterly growth in the real money stock in the area of the current (15-member) EU over 1972-95. The authors obtain adjusted R-squared's of 0.89, 0.68, and 0.77 for M1, M2 and M3 respectively. Though most of the restrictions make sense, it would perhaps be helpful to see what value the various elasticities take when the restrictions assumed by the authors do not take hold. Some of the restrictions could be justified better, particularly setting the sum of the wealth and income elasticities to one and forcing the coefficients on inflation and the long-term interest rate to be equal. However, it is reassuring that the models pass a range of stability and specification tests and that they do not seem very sensitive to the method used for aggregating across currencies.

The key element in this good performance, at least for the M2 and M3 models, is probably the inclusion of the ratio of financial wealth to income among the independent variables. This is justified as a way to incorporate portfolio motives for holding short-term money-market instruments. The authors support this by showing that Divisia indices for M2 and M3, which weight monetary components by liquidity, behave more or less similarly to M1 over the period studied. The authors attribute price stability in the 1980s, when broader monetary aggregates were rising, to the stability of wealth-adjusted money demand, though it must be said that in their graphs (Figure 3) wealth-adjusted money looks pretty stable in the 1970s as well.

In their conclusion, the authors suggest that this relationship is grounds for European monetary authorities to pay close attention to wealth accumulation. The question of whether excessive asset-price run-ups can be inflationary is certainly an interesting and timely issue. I would contend, however, that if anything the present paper offers evidence that wealth accumulation is *not* inflationary: the authors show that substantial increases in certain categories of liquid assets merely reflect portfolio decisions in the context of rising wealth, and not a build-up of the kind of liquidity pressures that are thought to be inflationary.