The determinants of the behaviour of the income velocity of money in Portugal
A long-run perspective: 1854-1998

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Abstract

We analyse the behaviour of the Portuguese income velocity of money (M2) in a long-run perspective and assess the importance of institutional factors as determinants of such a behaviour.

We present the yearly evolution of the Portuguese income velocity of money from 1854 (when Portugal precociously accepted the rules of the gold standard) to 1998 (when the Euro was about to become the Portuguese monetary unit as a consequence of Portugal being a member of the European Monetary Union).

Though the income velocity of money has traditionally been taken for the inverse of the demand for money and as such explained as a function of income and an interest rate, institutional changes, namely monetarization, the spread of commercial banks, financial sophistication and economic stability, proved to be important - in some cases, according to econometric tests, the most important - determinants explaining the U-shaped pattern in the long-run (Bordo; Jonung, 1981).

In a qualitative approach, significant institutional changes can be associated with the most important short and medium-run fluctuations of the income velocity series in Portugal. Nevertheless, a regression analysis using quantitative measures (proxy) of the institutional variables, along with the traditional economic and monetary variables, as independent variables, deepens the assessment of the relative importance of those factors in explaining the behaviour of the Portuguese income velocity of money (demand for money), which displays a downward trend till 1973 and the inverse trend from then on.

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