

Is there a Threshold Effect of Money Growth on Inflation?

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The recent global surge in inflation has revived academic interest in broad money growth in its relation to inflation. In this paper, we explore the non-linearity of the relationship between broad money growth and price inflation for the G20 countries. We focus on the 21st century data for the G20 countries with floating exchange rate regimes. We use an ARX model for inflation, where the X variable is nominal broad money growth. We test the null of a linear model against the alternative of a threshold on money growth with an unknown threshold level, using the test and estimation method developed by Hansen (2017). Our results indicate a strong rejection of the null hypothesis of linearity and the presence of two different regimes for high- and low-money growth rates. These findings suggest that central banks should adopt threshold-aware policies in order to prevent nonlinear money growth led surges in inflation.