

Long Run Money Demand, Long Run Spending Balance and Macro-Economic Fluctuations: Application of a Cointegrating SVAR Model to the Indonesian Macroeconomy

Author Info

Siregar, Hermanto (hermanto@mma.ipb.ac.id) (Faculty of Economics and Management, Bogor Agricultural University)

Ward, Bert D. (Wardb@lincoln.ac.nz) (Commerce Division, Lincoln University)

Abstract

A cointegrating SVAR model is used to represent the dynamics of the Indonesian macroeconomy. Through the cointegration analysis in the VEC methodology, long run relations among variables of the model are depicted by money demand and IS equations, whereas via the SVAR framework, shocks to aggregate supply, to spending balance, to demand for money and to monetary policy reaction function are identified. Despite the simple structure of the model, estimates of the long run relations and of the impulse response functions in this study provide empirical results that accord well with standard textbook macroeconomic theory. Although the demand for money and the IS functions are modelled to drive the long run dynamics of the model, shocks to the demand side of the economy can explain only small variability of output. Since shocks to aggregate supply remain the most important source of Indonesian macroeconomic fluctuations, then proper policy strategies aiming at improving technology or productivity would be more effective in order to stabilise the fluctuations.