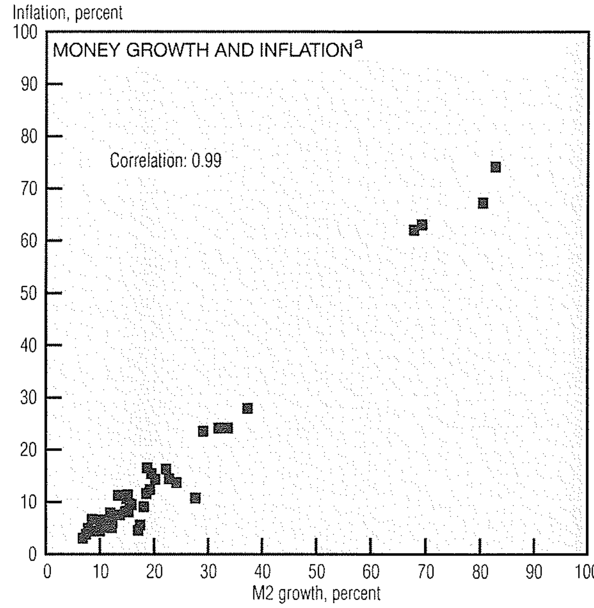
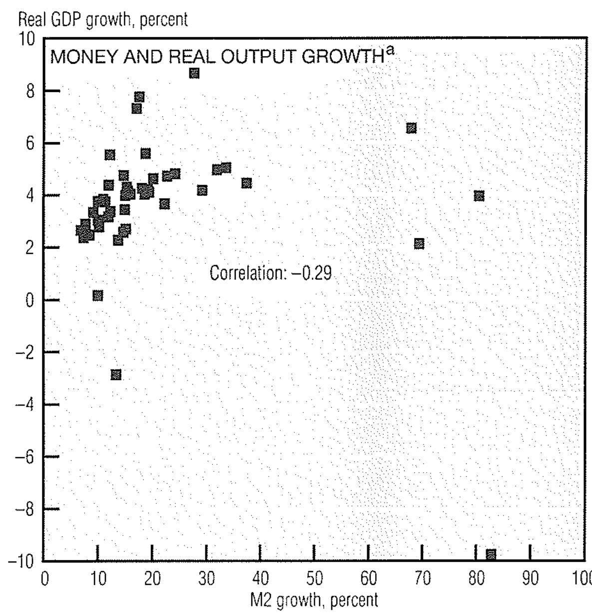
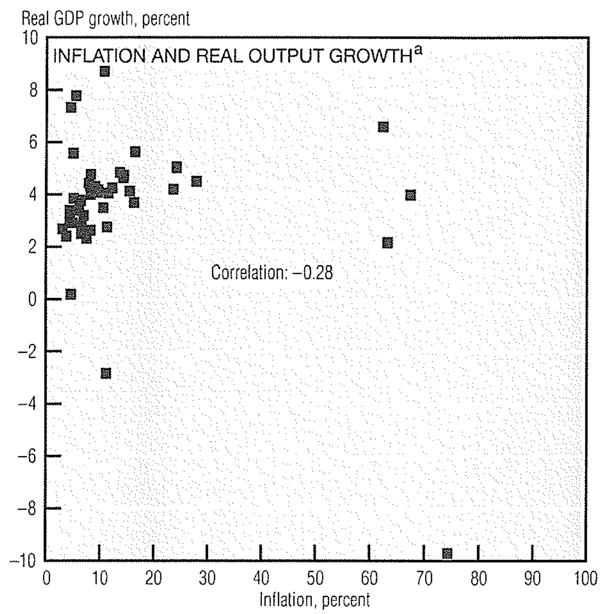
Monetary Policy and Economic Growth

Short-run Growth of Money and Output
(Correlation, year-over-year percent change)

	M2 lagged one year	M2 lagged two years
Canada	−0.17	−0.11
France	0.17	0.06
Germany	0.74	−0.13
Italy	0.62	0.42
Japan	0.72	0.51
U.K.	0.18	−0.19
U.S.	0.35	0.16







a. Average annual percent change.
NOTE: The sample includes 45 countries. All have at least 15 years of available data, and most have 35 years. See George T. McCandless, Jr. and Warren E. Weber, "Some Monetary Facts," Federal Reserve Bank of Minneapolis, *Quarterly Review*, Summer 1995, pp. 2-11.
SOURCE: International Monetary Fund, *International Financial Statistics*.

Although most economists will concede that monetary policy can affect real economic growth over the short run, many caution against attempting to manage business cycles through policy manipulation. Indeed, in most large industrial countries, faster money growth seems to precede faster economic growth by one year.

A causal connection between money and growth, however, requires that information about policy-induced price changes be imperfect. This may happen if some sectors of the economy have embedded outdated price expectations in binding contracts, if certain groups have better access to current price information than others, or if people generally have good information about the wages they earn and the prices they charge, but not about other prices.

In the long run, when information is complete and contracts can adjust, faster money growth increases neither output nor employment. As cross-country correlations reveal, faster money growth contributes only to inflation. Some economists warn that higher inflation may slow growth. If the public questions the stability of a currency's purchasing power, they will expend more time and energy protecting their financial wealth from inflation. Society will devote more resources to financial services and to the prompt adjustment of prices, while fewer resources will go toward capital accumulation and investments that enhance productivity.