**IMPACT: International Journal of Research in Business Management (IMPACT: IJRBM)**
**ISSN(P): 2347-4572; ISSN(E): 2321-886X**
**Vol. 4, Issue 9, Sep 2016, 89-98**


# THE ESTIMATION OF MONEYDEMAND ELASTICITY: CASE OF CROATIA

**IRENA PALIĆ[1], KSENIJA DUMIČIĆ[2] & DAJANA BARBIĆ[3]**

[1]Postdoctoral Researcher, Department of Statistics,
Faculty of Economics and Business, University of Zagreb, Zagreb, Croatia

[2]Professor, Department of Statistics, Faculty of Economics and Business, University of Zagreb, Zagreb, Croatia

[3]Assistant Professor, Department of Finance, Faculty of Economics and Business, University of Zagreb, Zagreb, Croatia

## ABSTRACT

The estimation of money demand function provides important insight for theory and policy making. The stable demand for money in the long run is very important for the implementation of monetary policy. The income and interest rate elasticity of money demand in Croatia is estimated in this paper using Johansen co integration method. In line with previous research, the quarterly data on money demand, interest rate and gross domestic product in Croatia are used in the co integration analysis. The trace test and maximum eigen value test both show the existence of one co integrating relation and the long run money demand function is estimated. In the long run both output and interest rate are significant in explaining money demand. The impact of domestic income on money demand is positive, while interest rate impact is negative, what is in line with relevant empirical research and economic theory. The error correction term shows that variables return into equilibrium for approximately13 quarters. The conducted analysis offers the coefficients of interest elasticity and income elasticity of money demand which can serve in future research for calibration of dynamic stohastic general equilibrium models of Croatian economy.

**KEYWORDS:** Co integration, Elasticity, Error Correction Term, Money Demand, Vector Error Correction Model

This work has been partially supported by Croatian Science Foundation under the project STRENGTHS no 9402.