# The Monetary Approach To The Balance Of Payments A Collection Of Research Papers By Members Of The Staff Of The International Monetary Fund

This book collects together the basic documents of an approach to the theory and policy of the balance of payments developed in the 1970s. The approach marked a return to the historical traditions of international monetary theory after some thirty years of departure from them – a departure occasioned by the international collapse of the 1930s, the Keynesian Revolution and a long period of war and post-war reconstruction in which the international monetary system was fragmented by exchange controls, currency inconvertibility and controls over international trade and capital movements.

This volume brings together several of the most important research papers on the monetary approach to the balance of payments prepared by IMF staff members. The 11 papers record, the contribution made by the IMF's staff to the development of the monetary approach, which is now widely accepted by academic economists and policymakers alike.

## The Monetary Approach to the Balance of Payments (Collected Works of Harry Johnson)Routledge

Current views about flexible exchange rate systems are based, to a large extent, on the lessons from the period of the 1920's during which many exchange rates were flexible. This paper re-examines the evidence from the perspective of the recently revived monetary approach (or more generally, asset-market approach) to the exchange rate. The analysis starts by developing a simple monetary model of exchange rate determination. The key characteristic of the model lies in the notion that, being a relative price of two monies, the equilibrium exchange rate is attained when the existing stocks of the two monies are willingly held. The equilibrium exchange rate is shown to depend on both real and monetary factors which operate through their influence on the relative demands and supplies of monies. The analysis then proceeds to examine the relationship between spot and forward rates for the Franc/Pound, Dollar/Pound and Franc/Dollar exchange rates and the results are shown to be consistent with the efficient market hypothesis. The monetary model is then estimated using monthly data and using the forward premium on foreign exchange as a measure of expectations. In addition to the single-equation ordinary-least-squares estimates, the various exchange rates are also estimated as a system using the mixed-estimation procedure which combines the sample information with prior information which derives from the homogeneity postulate and from known properties of the demand for money. The various results are shown to be consistent with the predictions of the monetary model.

We re-examine the monetary approach to the exchange rate from a number of perspectives, using monthly data on the deutschemark-dollar exchange rate. Using the Campbell-Shiller technique for testing present value models, we reject the restrictions imposed upon the data by the forward-looking rational expectations monetary model. We demonstrate, however, that the monetary model is validated as a long-run equilibrium condition. Moreover, imposing the long-run monetary model restrictions in a dynamic error correction framework leads to exchange rate forecasts which are superior to those generated by a random walk forecasting model.