THE DEMAND FOR REAL MONEY BALANCES IN NIGERIA: EVIDENCE FROM A PARTIAL ADJUSTMENT MODEL

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ABSTRACT

This study examined the demand for real money balances in Nigeria over the period 1971 to 2012. Using the partial adjustment model, the study showed that the transaction and precautionary motives for holding money, and the speculative motive are all important determinants of real money demand in Nigeria in the short run. The partial adjustment coefficient indicates that 4.1 percent of the discrepancy between desired and actual real money demanded is eliminated each year in the short run. Furthermore, in the steady state, after the adjustment process is complete, when the desired and actual money demanded are equal it is only the speculative motive that is an important driver of the demand for real money balances. The estimated money demand function is stable, indicating the absence of structural breaks in the demand for real money balances in Nigeria. The overall model was statistically significant and robust to serial correlation, even at the lag five (5). The study therefore concluded that in the short-run both real income and interest rates are important determinants of real money balances in Nigeria but it is interest rate that is important in the long – run, which therefore suggests the need to distinguish between short- and long-run monetary policy targets.

Keywords: Real Money Balances, Partial Adjustment, Expected Demand for money, Actual demand for money, speculative motive, precautionary motive, transactions motive.