**THE STABILITY OF THE DEMAND FOR MONEY in the EURO AREA**

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Monetary aggregates play a crucial role in monetary policy strategy of the Central Banks, since the reference value for monetary growth generally is taken as a benchmark for assessing monetary developments. For monitoring the inflation process, a stable money demand function is extremely important, at least as a long run reference. If this condition is met, money demand can be linked to the real economy. If the link between money and prices has become unstable, money growth cannot be considered a well-designed tool to analyze future inflation prospects and support policy decisions. This paper investigates the stability properties of the European Money Demand function by means of multivariate time series modelling for the time period 1980 -2010 using aggregated data of EU17, European Union member states which use the euro as their currency. A cointegration analysis identifies only one stable long-run relationship within a set of four macroeconomic variables, which can be interpreted as a money demand function. Empirical analysis suggests that the EU wide money demand function is not stable. According to the previous empirical literature on money demand, the instability of the money demand function can be due to the nonlinearity of the relationship. Hence, the nonlinearity in the short-run dynamics of the money demand function estimation has been investigated in the framework of “Error Correction Model” (ECM) and “Threshold Cointegration” models.

**Keywords:** European Money Demand, Vector Error Correction Model, Nonlinearity, Threshold Cointegration.

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