UNCOVERING THE GOODHART’S LAW: THEORY AND EVIDENCE

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ABSTRACT. This paper addresses the Goodhart’s Law in a cash-in-advance economy with monetary policy regime switching. Using the Japanese data of the money velocity, we found that although our cash-credit model fails to generate a downward trend in the actual velocity, the model succeeds in terms of velocity’s variation and correlations with money growth rates or nominal interest rates, with procyclicality of velocity unpredictable.

KEYWORDS. Goodhart’s Law, velocity of money, Taylor rule, Markov regime switching, cash-credit model.

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