Abstract

The subject of this thesis is the relationship that exists between deflation and the macroeconomic stability of the economy. Much literature has been published on this topic, but there is still a dearth of quantitative research based on strong empirical work. In the present work I have used a set of large panel data composed of 18 countries over 34 years in order to analyze the relationship between changes in inflation and output growth in a more complete and rigorous fashion.

I use 3 different econometric models, namely fixed effects, random effects and the generalized method of moments. I chose these models in order to more appropriately examine the contemporaneous and lagged correlation between prices and output of countries. I also introduced foreign direct investment as a control variable to avoid the presence of potential bias.

The empirical work presented in this paper leads to several findings. First, there is an insignificant relationship between a country's GDP growth and its deflation rate. Second, the relation between inflation and GDP growth is significant, and this relation becomes even positive when the econometric model is conducted on the data excluding outliers. Third, FDI positively contributes to and is partly responsible for the level of economic growth of the countries included in the analysis.

The paper's analysis determines that one of the most effective tools for reversing deflation into inflation is quantitative and qualitative easing, which can be implemented by central banks.

JEL Classification C33, E31, E52, G01

Keywords deflation; macroeconomic stability; price; economic growth; monetary policies; consumer price index; large panel data;

Author's e-mail marina.gorobetchi@gmail.com

Supervisor's e-mail pavel_ryska@volny.cz