Abstract

The failure of Japan's recent quantitative easing to uplift its economic stagnation, which had taken place since early 90s, brought a notion of liquidity trap problem. The liquidity trap is hard to tackle and trough an irresponsive money market, bound to render some of monetary measures of central bank powerless. One way to alleviate this problem is by avoid it in first place, a monetary injection in a right time on a right scale before the onset of the trap. To do this, an estimate on when and where the liquidity trap will occur are needed. This paper sought to explore possibilities in estimating the outset of liquidity trap using method based on Howard W. Pifer paper in 1969 titled 'A Nonlinear, Maximum Likelihood Estimates of the Liquidity Trap' and examine characteristics of resultant model. Using logarithmic transformation and linear ordinary least squares method upon a set of M1 and interest rate data of Japan and United States, it was found that although the resultant model could correctly predicted the existence of liquidity trap in sample countries, it is not sufficiently robust and had pervasive autocorrelation problem.

Keywords: liquidity trap, interest rate, M1, liquidity preference theorem, Japan.