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PERMANENT INCOME HYPOTHESES TESTING: EVIDENCE FROM RUSSIA

Abstract:

Consumption and income nexus is determined either by permanent income hypothesis or excess sensitivity hypothesis. Our study is based on the study Campbell and Mankiw (1989), who conducted analysis for the US. In our study, we test the aforementioned hypotheses in the context of Russia using quarterly data. Afterwards, we check whether sensitivity of consumption to disposable income depends on economic development of a country. Therefore, we test permanent and excess sensitivity hypotheses in the context of developed and developing countries. By employing Campbell-Mankiw model we use two-stage least squares method using instrumental variables. The results demonstrate that the best instruments for Russia are lags in income, oil price and interest rate. All Russian agents consume their temporary income, which is an indicator of a risky financial environment. When considering the groups of developed and developing countries, the results demonstrate that developing countries with relatively better financial system comprise two groups of agents: a group consuming permanent income and a group consuming temporary income. At the same time, in some developed countries having less stable financial system, all agents consume their temporary income.

Keywords:

Excess sensitivity, consumption, permanent income hypothesis, random walk hypothesis, Friedman function

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