

## THE INFLATION-GROWTH NEXUS ACROSS COUNTRIES UNDER SIMULTANEOUS EQUATIONS MODEL

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### ABSTRACT

*This paper investigates the causal relationship between inflation and economic growth using a broad cross-country data over the 1970-2005 period. The identification and estimation of the structural parameters of interest can be easily achieved by following the novel approach of Lewbel (2011). This implies that conventional empirical studies that analyze the causal relationships between inflation and growth separately suffer from endogeneity bias. After removal of the simultaneous bias, we find that inflation and growth are significant interrelated as predicted by recent theories. Most importantly, our results indicate that inflation is harmful to growth whereas the effect from growth to inflation is beneficial. Moreover, we split our cross national dataset into high income, low income and developing countries, and the results indicate that the negative impact of inflation on growth in low income countries is greater than in developing and high income countries. On the other hand, we exploit the difference in effect of growth on inflation in different income level countries. Higher economic growth no longer results in improvement of inflation in high and low income countries. On the contrary, rapider economic growth induces higher inflation in low income sample countries.*

**Keywords:** *Economic Growth; Inflation; Simultaneous equations; Endogeneity bias*

**JEL classification codes:** O40; O15; E25