

Testing the Stochastic Implications of Permanent Income Hypothesis Using Canadian Provincial Data

by

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Abstract

This paper utilizes relatively unexplored Canadian provincial-level data to investigate an old but still relevant question in macroeconomics as to whether consumption responds to income innovations in a manner consistent with the stochastic implications of the permanent income hypothesis (PIH). The empirical results obtained do not appear to be in accord with the PIH. Instead consumption's response to income innovations is found to be much weaker than the PIH predicts; in particular, the response displays an asymmetric pattern in the sense that it is much stronger for negative than positive income innovations. We interpret this evidence of asymmetry as indicative of the presence of liquidity constraints in provincial households.

JEL Classification: E20, E21, R10

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