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Does the Inverse Interest Rate-Investment Nexus Hold in the US? A re-examination with the Dual Adjustment Approach

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ABSTRACT

The lack of cointegration may potentially arise from intrinsic misspecification issues regarding the dual adjustment of the different components of the time series variables as well as the specification of the trend. This paper presents an alternative explanation for the lack of long-run relationship observed in some empirical applications by utilizing the Dual Adjustment approach, which allows one to investigate the dual co-movements of the permanent and transitory components of time series variables. This study extends this approach by considering the critical role of the specification of dual components with an application to the private sector equipment investment in the U.S. Our results reveal that when the series are dually adjusted with each other the traditional cointegration approach may cause a structural misspecification that leads to wrong estimation results and spuriousness. This study also sheds light on the controversial findings on the interest rate-investment nexus.

KEYWORDS Dual Adjustment Approach; cointegration; equipment investment; misspecification

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