

ASEAN-5 EXCHANGE RATE DETERMINATION IN THE PRESENCE OF NONLINEARITY

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This study finds that nominal exchange rate exhibits nonlinear long-run relationship with money supplies and aggregate outputs, in the context of ASEAN-5 countries, thereby validating the monetary model of exchange rate. While it is consistent with the earlier findings using the linear testing procedures in this region, the current evidence of nonlinear relationship provides insightful information in explaining why nominal exchange rate misalignments can sometimes be persistent in the short-run. With regard to the monitoring of exchange rates in these countries, policy makers could focus on the set of monetary variables, which have been shown well-coordinated with the dynamic of exchange rates in this study.

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Keywords: Exchange Rate; Monetary model; nonlinearity; Cointegration

1. INTRODUCTION

The debate on whether or not nominal exchange rates exhibit long-run relationship with the monetary fundamentals has occupied much of international finance researchers' time ever since the break down of the Bretton-Woods system in the mid-1973. To this end, empirical evidence is not as supportive of the monetary model as the theory suggests (see among others, Meese and Rogoff, 1983; Lyons, 2002; Cheung et al. 2005). Recently, there is a growing consensus among researchers that the lack of supportive evidence may largely be associated to the negligence of the

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