THE RISK-ADJUSTED INTEREST RATE PARITY: PANEL DATA EVIDENCE

ABSTRACT

The interest rate parity relationship is analysed with and without the inclusion of a time-varying risk premium. A panel data set of returns on Eurocurrency deposits is used to test for a panel unit root as well as for common movements in the risk premia across deposits denominated in different currencies. The results showed that each variable in the panel is stationary. The main empirical finding is that the UIP is not supported for any country in the sample except perhaps for Japan indicating support for the Risk-adjusted uncovered interest parity model but not for the UIP without a risk premium included. That evidence is then regarded as support for the Risk-adjusted UIP assumption underlying the Portfolio model of exchange rate determination.

Keywords: Eurocurrency; Interest rate parity; Panel unit root test; Risk premia
JEL Classification: F31, F30, C33

La parità dei tassi di interesse aggiustata per il rischio: evidenza empirica

In questo lavoro viene esaminato il rapporto tra la parità dei tassi di interesse con e senza un premio al rischio variabile nel tempo. Viene utilizzata una serie di dati sui rendimenti dei depositi e dei titoli a più lunga scadenza denominati in Euro e in valute diverse. I risultati ottenuti mostrano che ciascuna variabile è stazionaria. L’evidenza empirica mostra che la parità scoperta dei tassi non è applicabile a nessuno dei paesi del campione esaminato, eccetto il Giappone. Ciò supporta l’utilizzo del modello della parità scoperta dei tassi di interesse aggiustata per il rischio e non del modello che prescinde dal rischio. I risultati ottenuti devono essere tenuti in considerazione come sostegno dell’ipotesi della parità scoperta dei tassi aggiustata per il rischio sottostante il modello di portafoglio della determinazione del tasso di cambio.
The increased heterogeneity of the European market after the prospective joining of the acceding countries to EMU could imperil the latter’s stability. It is widely expected that following enlargement the optimality conditions of the eurozone will decrease, implying a more difficult stabilisation task for the governance authorities of EMU. Yet all this does not necessarily imply a possible disruption of EMU. In the paper two exercises are presented for assessing the impact of enlargement on the eurozone. The first one focuses on co-movement of some crucial variables for countries representative of acceding countries, on the one hand, and of EMU, on the other. The second exercise is aimed at identifying sign and level of correlations between the cycles of EMU-12 and those of each acceding country, the assumption being that positive, high correlations can be considered as evidence of low risk of shock asymmetry and hence of optimality conditions. Cycles were singled out from the GDP series extracting from the latter the trends by means of the Hodrick-Prescott filter. The majority of the correlations proved positive, and in a number of cases also their level was quite satisfactory. The outcome of the exercises shows that acceding countries share with EMU a number of common structural features. In particular, the only threat posed to the stability of an enlarged EMU could come from divergences still present in the former Czechoslovakia, but combined the two Czech and Slovakia Republics, in terms of GDP produced, represent only one percentage point of EMU-12.

Keywords: Enlargement, OCA, euro, EMU
JEL Classification: F31, F33, F36
EXTERNAL AND DOMESTIC GROWTH FORCES IN THE PERFORMANCE OF EUROPEAN UNION ECONOMIES

ABSTRACT

The interaction of the export ratio and the investment ratio, including foreign direct investment ratio, with income per capita was examined for all members in the EU using Granger-causality tests. Best results were obtained when the investigated variables were expressed in levels. These results bring to light a significant number of causality relations. From bidirectional causalities between (a) the export ratio and GDP per capita and (b) the investment ratio and GDP per capita there is prima facie evidence in support of Myrdal’s hypothesis of cumulative circular causation, and of small countries being primary beneficiaries from EU participation. Evidence for the importance of foreign direct investment was generally lacking, suggesting that the new EU members will be disappointed if they wrongly expect stimulation of their economies from foreign capital inflows.

JEL Classification: f15, f33, f36

Determinanti interne ed esterne della crescita nei paesi dell’Unione Europea

In questo articolo vengono svolti dei test di causalità-Granger per esaminare l’interazione tra la quota di esportazioni e la quota di investimenti (compresa la quota di investimenti diretti esteri) ed il reddito pro-capite per tutti i paesi membri dell’Unione Europea. Si ottengono migliori risultati quando le variabili oggetto di indagine vengono espresse in termini di livelli. I risultati raggiunti mostrano un numero significativo di relazioni causalì. Dalle relazioni di causalità reciproca tra (a) la quota delle esportazioni e il PIL pro-capite e (b) la quota degli investimenti e il PIL pro-capite emergono argomentazioni a favore dell’ipotesi di Myrdal riguardo un rapporto di causalità circolare e, nello specifico, sul fatto che nell’Unione Europea i principali beneficiari di tali effetti siano i paesi più piccoli. Secondo questo studio gli investimenti diretti esteri rivestono minore importanza. Pertanto i nuovi membri dell’UE resteranno delusi se si aspettano una stimolazione delle loro economie da parte dei flussi di capitale provenienti dall’estero.
This paper examines the question whether fiscal deficits generate inflation from a long term perspective. Cointegration and Granger-causality tests with structural breaks are employed. Using long-run data for Portugal, we have shown that the price level and fiscal deficits, whether measured in amounts or as percentages of output, contain unit roots. Structural changes at various break dates do not affect their unit root processes. The price level and deficits ratios are cointegrated but the price level and deficit amounts are not. The price level and fiscal deficits as ratios of deficits to output move in an equilibrium relation in the long run. In the short-run, the error-correction model shows a feedback effect between them: higher deficit ratio raises the price level one period which in turn contributes to higher deficit ratio in the next period. Growth in deficits, whether measured by amounts or by deficit-output ratios, positively Granger-causes inflation for the whole period 1850-1985. The view held by demand oriented theories such as the traditional Keynesian, the new Keynesian, and the new classical schools appears to be supported by the longterm data for Portugal: not only fiscal deficits tend to raise the price level, but their growth also tends to raise inflation. In addition, the Tanzi-Oliver effect is also confirmed in the error-correction model: rising prices worsen the fiscal deficits. Our results contradict both the supply-side economics and the Ricardian equivalence notion that fiscal deficits do not raise the price level or that an increase in fiscal deficits do not lead to inflation.

JEL Classification: E63
MODELLING MONETARY POLICY IN A SMALL OPEN ECONOMY: EVIDENCE FROM A NEW ZEALAND SVAR MODEL

ABSTRACT

The primary objective of this study is to examine empirically the effects of monetary policy in a small open economy. This is based on an econometric analysis of ways in which a monetary policy shock affects key macroeconomic variables in New Zealand. To achieve this objective, a parsimonious macroeconometric model is developed using well known Contemporaneous (Short-Run) SVAR techniques. Past empirical research on the effects of monetary policy in closed and open economies found evidence of several anomalies, such as the liquidity, price, exchange rate and forward discount bias puzzles. To resolve these puzzles, the study constructs a Contemporaneous SVAR model (called NZSVAR model) and formulates identification schemes that lead to computation of impulse response functions that are free of these empirical anomalies. The results show that we have successfully modelled monetary policy effects in New Zealand without encountering those anomalous responses often documented in previous literature.

JEL Classification: C51, E32