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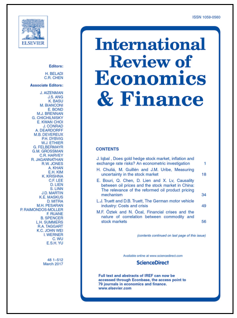

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Do Short-term International Capital Movements Play a Role in Exchange Rate and Stock Price Transmission Mechanism in China?☆

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ABSTRACT

This paper applies wavelet analysis to investigate the role of short-run international capital movements (SICM) in the interaction mechanism between the exchange rate and stock prices (SP). The bilateral co-movements between these three variables are time-varying and inconsistent in some periods, and the flow of SICM is insufficient to explain the difference between the results obtained by testing SP and exchange rate nexus alone and then testing it taking SICM as a control variable, thus indicating a limited mediating role for SICM. However, SICM still cannot be ignored with the process of Renminbi internationalization and capital account liberalization.

Keywords: Exchange Rate; Short-term International Capital Movements; Stock Price; Wavelet Analysis
JEL：C1; G1

1. Introduction

The exchange rate, short-term international capital movements (SICM) and stock prices (SP) are crucial variables in the macroeconomics of the open economy. From the perspective of international finance, the sensitivity of capital flows to the exchange rate has been extensively studied in the literature (Calvo, Leiderman & Reinhart, 1993; Combes, Kinda & Plane, 2012). With increased globalization and financial integration, capital flows now account for the largest share of cross-border transactions (Hau & Rey, 2004). Moreover, Lane & Shambaugh (2010) indicate that trade-weighted exchange rate indices are insufficient to explain the financial impact of currency movements. In particular, the movement of SICM has always had a speculative characteristic (Arndt, 1968). The rapid movement of short-term capital can cause fluctuations in the exchange rate and further influence the decision making of international speculators. Theoretically, large inflows of short-term international capital aimed at the stock market, the real estate market or other assets cause increased asset prices (Sarno & Taylora., 1999). The pessimistic expectations of speculators on the capital market can cause large outflows of international capital and

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