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Authors: Sanjay Sehgal, Piyush Pandey, Florent Diesting

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Examining Dynamic Currency Linkages amongst South Asian Economies: An Empirical Study

Sanjay Sehgal¹, Piyush Pandey^{2*}, Florent Diesting³

JEL Classification: C13, C52, F21, F36, G15

1. Professor, Department of Financial Studies, University of Delhi, Delhi, India, 110021
 Email: sanjayfin15@yahoo.co.in Contact: +91-11-24116570
 2. Research Scholar, Department of Financial Studies, University of Delhi, Delhi, India, 110021
 * Corresponding Author can be reached at finmanpiyush007@gmail.com Contact: +91-11-24118854
 3. Professor, Groupe ESC Pau – France, rue Saint-John Perse - BP 7512 – 64075, France
 Email: florent.deisting@esc-pau.fr

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Abstract

In this paper, we examine the currency market linkages of South Asian member countries using daily data from 6 January 2004 to 31st March 2016. Time invariant and varying Copula GARCH models show that South Asian countries, except for India and Nepal/ Bhutan, have low levels of currency market linkages which can be ascribed to poor levels of intra-regional trade intensity and portfolio flows. We reconfirm the copula results through Diebold and Yilmaz methodology and document that currency market connectedness is very limited in the South Asian region. The trends of the fundamental determinants of currency co-movements for the South Asian member countries were compared with its neighbouring regional economic bloc in Asia which has a much longer history and a wider membership base i.e ASEAN+6. From a comparative analysis, it was found that South Asia member states have to work on their governance parameters, improve on their trade linkages and trade tariffs and work towards greater degree of capital account convertibility with adequate safeguards to achieve higher levels of currency market linkages.

Keywords: currency market integration; ; ; ; , currency linkages, South Asia, SAARC, time varying copula, Diebold and Yilmaz

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1. Introduction

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