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Exchange Rate Dynamics and Stock Prices in Small Open Economies: Evidence from Asia-Pacific Countries

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Abstract

This study investigates the short-run and long-run dynamics between exchange rates and stock prices and the path through which monetary policy shocks impact on these markets in four small open economies in the Asia-Pacific region over the period 1999-2016. Three aspects of the dynamics being explored include 1) the efficiency of stock price responses to exchange rate and monetary policy shocks; 2) the dynamics of exchange rate movements in responding to stock price and monetary policy shocks; and 3) the causality between exchange rate and stock price changes in the short run and long run. Three conclusions are drawn from this study. First, while the impact of monetary policy shocks to stock price changes are contemporaneous for all four countries, stock price changes converge to the baseline relatively apace in Singapore and Hong Kong than in Taiwan and South Korea. Second, exchange rate shocks cause less short-run volatility in the stock markets of Singapore and Hong Kong though the long run convergence to the baseline in all of the four countries takes approximately equal amount of time. Third, an exchange rate shock induces an instantaneous change in the stock price but a stock price shock leads to a gradual variation in the exchange rate of all four countries.

Keywords: Exchange rates; monetary policy shocks; small open economy; stock prices; SVAR

JEL Classification: C32, E43, E52, F31

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