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Financial integration of East Asian economies: evidence from real interest parity

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Notes

¹ Chinn and Frankel ([1995](#)), for instance, found that although Indonesia and Thailand were integrated with Japan, RIP holds only for US–Singapore, US–Taiwan and Japan–Taiwan. On the other hand, Phylaktis ([1997](#), [1999](#)) found that Asia-Pacific capital markets are considerably integrated but that the results regarding the US's and Japan's leading roles in the regional market are contradictory.

² We note that interest rates were under strict control of the People's Bank of China (PBC). It is based on the market-based rate of the world.

³ Japan and the world in international trade. Some of these large economies and

⁴ China, Germany, Japan and investment (FDI) inflows.

⁵ The US and Japan. In 2002, total trade recorded at US\$ 100 billion, while those from Japan were about US\$ 4.2 billion.

⁶ Cheung et al. ([2006](#)), however, relied on univariate unit root tests (without breaks) to infer on the status of real and financial integration. In this article, the authors concluded that long-run version of parity conditions (RIP, Purchasing Power Parity – PPP and Uncovered Interest Parity – UIP) hold among Greater China economies despite the different types of trade barriers and capital controls in China and Taiwan.

⁷ Panel methods have become more prominent in recent years since several authors have documented that even for long-run data the available time series suffer from severe size distortion and low power. It is well known that the power of unit root tests for a given sample size can be increased by exploiting cross-sectional information (Levin and Lin, [1993](#)). As such, panel unit root tests have found wide application in testing PPP. For some application of the various panel unit root tests, see Taylor and Sarno ([1998](#)), Wu ([1996](#)) and O’Connell ([1998](#)). Some serious drawbacks of these panel tests were also investigated in O’Connell ([1998](#)), Taylor and Sarno ([1998](#)) and Breuer et al. ([2002](#)).

⁸ Japan began the reform in mid-1970, while the foreign exchange market was liberalized in late 1980. In our sample, China was the last to join the race. It has a slower pace of liberalization of lending and deposit rates that started in 1996. It is difficult to select a date for structural break since financial reforms were not introduced at the same time and intensity.

⁹ For more information, see a recent paper by

¹⁰ Taylor and Sarno (1998) show that these tests are biased to

¹¹ Since the late 1990s, the liberalization of capital flows was

¹² O’Connell (1998) shows that these tests are biased to (rejects) the null hypothesis of PPP across Greater China economies. This demonstrates that the power of these tests drops significantly

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¹³ For more discussions on the power of these panel unit root tests, see two recent papers by Banerjee et al. ([2005](#)) and Hlouskova and Wagner ([2006](#)). These authors argue that the so called first generation panel unit root tests (e.g. LLC and IPS) are designed for cross-sectional independent panels.

¹⁴ Results of power analysis by Breuer et al. ([2001](#)) show that the power of the SURADF are substantially higher in comparison to the commonly used panel unit root test.

¹⁵ There are several other alternative proposals formulated in the literature to overcome the cross-section dependence problem. For more detailed discussion on these tests, see for example Camarero et al. ([2009](#)).

Related Research Data

REAL INTEREST RATE PARITY AND FOURIER QUANTILE UNIT ROOT TEST

Source: Wiley

Malaysia-China in the Liberalization Era: Structural Modelling of International Parity Conditions and Transmission Mechanism

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