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Home ► All Journals ► Economics, Finance & Business ► Applied Economics ► List of Issues ► Volume 43, Issue 16 ► Financial integration of East Asian econ

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Original Articles

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

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Notes

¹ Chinn and Frankel (<u>1995</u>), 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 (<u>1997</u>, <u>1999</u>) 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
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US\$ 100)2, while
those from Japan were about US\$ 4.2 billion.	

⁶ Cheung et al. (<u>2006</u>), 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, <u>1993</u>). 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 (<u>1998</u>), Wu (<u>1996</u>) and O'Connell (<u>1998</u>). Some serious drawbacks of these panel tests were also investigated in O'Connell (<u>1998</u>), Taylor and Sarno (<u>1998</u>) and Breuer et al. (<u>2002</u>).

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.



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. (<u>2009</u>).

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