Applied Economics Letters ›

Volume 11, 2004 - Issue 6

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New Zealand's trade balance: evidence of the J-curve and granger causality

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Pages 351-354 | Published online: 19 Aug 2006

Cite this article https://doi.org/10.1080/1350485042000228187

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Abstract

This article tests for the existence of any cointegration relationship between trade balance and real effective exchange rate (REER), foreign income and domestic income for New Zealand during the period 1970–2000. It also examines the direction of the casual relationship between the above variables, and applies the impulse response analysis to determine whether shocks to the REER induce the trade balance to follow a J-curve pattern. The results indicate that there is no cointegration relationship between the above variables; there is a casual connection in both directions between trade balance and foreign income; and New Zealand's trade balance exhibits a J-curve pattern when there is a depreciation of the New Zealand dollar.

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