

The Yen and the External Position: Long-Run Relation

- Classical 'transfer problem'
- Following the setup described in Lane and Milesi-Ferretti (2002b, 2004) as modified by Galstyan (2007), we estimate the following specifications

$$REER_t = \alpha_R + \beta_R \left(\frac{TB_t}{Y_t} \right) + \gamma_R YDIFF_t + \delta_R DIFFPROD_t^T + \varepsilon_{Rt}$$

$$TOT_t = \alpha_T + \beta_T \left(\frac{TB_t}{Y_t} \right) + \gamma_T YDIFF_t + \delta_T DIFFPROD_t^T + \varepsilon_{Tt}$$

$$\left(\frac{P_t^N}{P_t^T} \right) = \alpha_N + \beta_N \left(\frac{TB_t}{Y_t} \right) + \delta_N RELSPROD_t + \sigma_N DIFFPROD_t^T + \varepsilon_{Nt}$$

Table: The Trade Balance and Relative Prices

	(1) REER	(2) TOT	(3) PN/PT
Trade Balance	-5.8 (5.2)	-10.9 (4.0)**	-5.2 (2.0)**
Relative Output	2.6 (1.24)*	0.57 (1.1)	
Diff. Prod. In Tradables	-3.4 (1.4)**	-0.33 (1.1)	-0.75 (.44)
Rel. Sect. Prod.			-0.65 (.23)**
Adj. R2	0.56	0.51	0.96

Estimation by DOLS. ***,**, * denote significance at 1, 5 and 10 percent levels respectively.

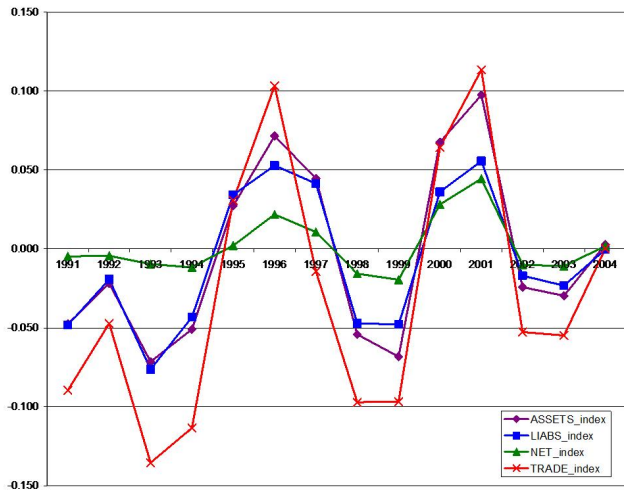


Figure: Dynamics of Trade and Financial Exchange Rates, 1991-2004.

Short-Run Dynamics

- Error correction representation
- Valuation Channel
- Joint short-run dynamics of capital flows and the exchange rate

Valuation Channel of Currency Movements

Lane and Shambaugh (2007) calculate

$$I_{it}^A = I_{it-1}^A * \left(1 + \sum \omega_{ijt}^A * \% \Delta E_{ijt} \right) \quad (6)$$

$$I_{it}^L = I_{it-1}^L * \left(1 + \sum \omega_{ijt}^L * \% \Delta E_{ijt} \right) \quad (7)$$

$$VAL_{it}^{XR} = \% \Delta I_{it}^A * A_{t-1} - \% \Delta I_{it}^L * L_{t-1} \quad (8)$$

Also define aggregate foreign currency exposure by

$$FX_{it}^{AGG} = \omega_{it}^A S_{it}^A - \omega_{it}^L S_{it}^L \quad (9)$$

and the net impact on the external balance sheet is

$$NETFX_{it} = FX_{it}^{AGG} * IFI_{it-1} \quad (10)$$

Table: Net Currency Exposures, 1990-2004

year	Yen	US Dollar	Euro	Sterling
1990	-1.5	4.2		1.1
1991	1.0	2.6		1.0
1992	2.2	2.2		1.0
1993	3.4	3.1		0.9
1994	2.3	4.7		0.9
1995	0.6	6.1		0.9
1996	-0.6	8.4		1.2
1997	-1.6	10.6		1.4
1998	1.4	5.5		1.6
1999	-3.9	15.8	8.1	1.9
2000	-14.0	16.7	9.3	2.1
2001	-9.8	19.9	10.8	2.8
2002	-8.3	22.8	12.7	2.9
2003	-8.9	22.5	13.3	2.8
2004	-15.0	26.2	15.2	3.4

Net Currency Positions as a ratio to GDP. Source: Author's calculations, based on dataset of Lane and Shambaugh (2007).

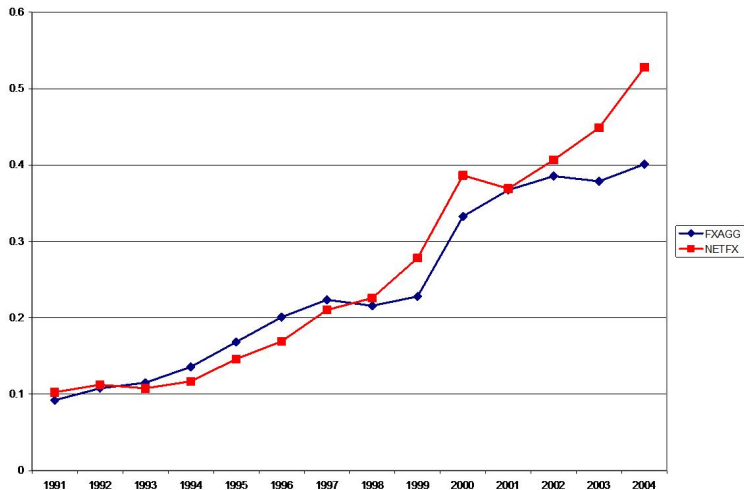


Figure: Aggregate Foreign Currency Exposure, 1991-2004.

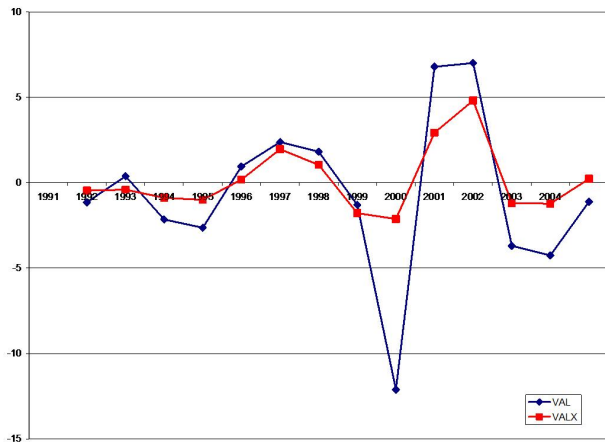


Figure: Valuation Channel and the Exchange Rate.

The Macroeconomic Impact of Financial Globalisation

- Financial Globalisation and Economic Performance: impact of financial integration on productivity
- Evidence of international risk sharing?
- Impact on conduct and transmission of monetary and fiscal policies

Looking to the Future and Conclusions

- Projections for external account and the real exchange rate
- Impact on macroeconomic performance
- Policy Issues