

Revisiting Purchasing Power Parity and Uncovered Interest Parity: Evidence from G7 Exchange Rates Using a Dynamic Joint Model

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Abstract : This research investigates the concept of purchasing power parity (PPP) among the G7 nations subsequent to the introduction of the euro currency. It proposes a dynamic joint model to decompose the real exchange rate (RER) into two distinct components, facilitating an examination of PPP prevalence, and unraveling the impacts of speculative flow of money on the RER. The analysis reveals that the parity between the UK and eurozone countries has shown consistent strengthening, while parity with Japan has experienced a delicate process of convergence. During the Global Financial Crisis (GFC), the US dollar emerges as a safe-haven currency, while the Japanese yen remains resilient, affirming its status as a refuge asset. Conversely, Canadian dollar displays depreciation relative to its G7 counterparts during the GFC.

Keywords : purchasing power parity, uncovered interest parity, state-space

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