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Extended generalized purchasing power parity and optimum currency area in East Asian countries

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Abstract
This article extends the theory of generalized purchasing power parity (G-PPP) by developing a model including foreign variables such as the real money supply, output and interest rate. A cointegration rank test with two structural breaks in the deterministic trend was adopted to selected Asian countries, with Japan as the base country. There were two cointegrating vectors and six common stochastic trends in the model. The cointegrating vectors were estimated by the same approach used by Pesaran et al. (2000). The first cointegrating vector is interpreted as G-PPP, and the second one is interpreted as the extended G-PPP. According to G-PPP, these countries could form a single currency area. The first stochastic trend is primarily driven by Japan's real money supply; the second, third and fourth by the real exchange rates of the Philippines, Singapore and Thailand, respectively; the fifth by Japan's output; and the sixth by Japan's government bond yields. © 2010 Taylor & Francis.

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