

MASTER'S THESIS

The influences of external factors on interest rates and exchange rates in industrialized countries

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**The Influences of External Factors on Interest Rates and
Exchange Rates in Industrialized Countries**

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A thesis submitted in partial fulfillment of the requirements

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Master of Philosophy

Principal Supervisor: Dr. Bill W.S. HUNG

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Abstract

The causes for and changes of the volatilities of the exchange rates and interest rates among the industrialized countries have been the subjects of controversial debate. It is interesting to note that the fluctuations of the exchange rate markets have narrowed, which is contrary to the global trend, but the variations of the interest rate markets have enlarged, which is consistent with the global trend after 1990. This thesis studies two main issues for the causes and the changing variations of exchange rates as well as interest rates by employing the co-integration method, variance decomposition analysis and impulse response technique, with detailed descriptive analysis. First, the sources of the exchange rate movements are examined and investigated as to whether there is a significant change resulting from the shocks. Second, the correlation between the capital and exchange rate markets in limiting the variations of the exchange rate markets is determined. Empirical findings conclude that the real demand, or internal shocks, are gradually replaced by monetary and real supply, or external shocks, following variations in the exchange rates after 1990. Additionally, the tight connection between each industrialized country's capital markets supports the increasing volatilities of capital markets in the past decade and confirms the possibility of a single global capital market.

Table of Contents

<i>Declaration</i>	i
<i>Abstract</i>	ii
<i>Acknowledgements</i>	iii
<i>Table of Contents</i>	iv
<i>List of Tables</i>	v
<i>List of Figures</i>	v
Chapter 1 Introduction	1
1.1 Introduction	1
1.2 Objectives and Structure of this Thesis	3
Chapter 2 Overview of the Volatilities of Exchange Rates and Interest Rates	10
2.1 Introduction	10
2.2 Overview of the Magnitude of Global Economic Integration	10
2.3 The Circumstances of the Exchange Rate Markets	13
2.4 The Circumstances of the Interest Rate Markets	19
2.5 The Influential Power of the US	22
2.6 The Fundamental Sources of Exchange Rate and Interest Rate Variations	26
Chapter 3 The Changing Influences in Exchange Rates Before and After 1990	32
3.1 Introduction	32
3.2 Theoretical Issues Discussion and Literature Review	35
3.3 The Empirical Issues in Model Specification and Estimation Method	42
3.4 Data Description and Empirical Results	53
3.5 Conclusions and Policy Implications	63
Chapter 4 The External Effects on Interest Rates and Exchange Rates among Industrialized Countries	72
4.1 Introduction	72
4.2 Theoretical Issues Discussion and Literature Review	77
4.3 Data Description and Methodology	83
4.4 Empirical Findings	92
4.5 Conclusions and Policy Implications	96
Chapter 5 Conclusion: Looking Beyond the Interest Rate and Exchange Rate Markets	115
References	120
Curriculum Vitae	128