

Accepted Manuscript

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PII: S2110-7017(17)30072-0

DOI: [10.1016/j.inteco.2018.02.001](https://doi.org/10.1016/j.inteco.2018.02.001)

Reference: INTECO 161

To appear in: *International Economics*

Received Date: 2 April 2017

Revised Date: 11 February 2018

Accepted Date: 12 February 2018

Please cite this article as: Chong, T.T.L., Yan, I.K., Forecasting currency crises with threshold models, *International Economics* (2018), doi: 10.1016/j.inteco.2018.02.001.

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Forecasting Currency Crises with Threshold Models

Terence T. L. CHONG* and Isabel K. YAN†

Abstract

This paper develops a multi-factor threshold model to provide warning signals for currency crises. Using a panel data set for 16 economies over 20 years, it is found that the ratio of short-term external liabilities to reserves and the lending rate differential are valid threshold variables that can segregate “turbulent” from “tranquil” regime. The corresponding threshold estimates can provide useful pivotal points for governments to formulate regulatory policy measures to reduce the risk of financial crises.

Keywords: Threshold Model; Multiple Threshold Variables; Currency Crisis; Panel Data.

JEL Classification Number: C33; C12; C13

*We would like to thank Bruce Hansen, Gregory Chow, W.K. Li, and the seminar and conference participants at the Chinese University of Hong Kong, the University of Hong Kong, the 14th International Conference on Panel Data in Xiamen, China, and the International Conference in Economics and Finance in Labuan, Malaysia for helpful comments. We also thank Gilbert Lui and Haiqiang Chen for able research assistance. Any remaining errors are ours. Corresponding author. Terence Chong, Department of Economics, The Chinese University of Hong Kong, Hong Kong. E-mail: chong2064@cuhk.edu.hk. Web-page: <http://www.cuhk.edu.hk/eo/staff/tlchong/tlchong3.htm>.

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