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Ahmad Zubaidi Baharumshah, Siew-Voon Soon, Mark E. Wohar



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**Markov-switching analysis of exchange rate pass-through:
Perspective from Asian countries**

Ahmad Zubaidi Baharumshah^{*a,b}, Siew-Voon Soon^{b,c} and Mark E. Wohar^{d,e}

^aFinancial Economics Research Centre, Faculty of Economics and Management,
Universiti Putra Malaysia, 43400 UPM Serdang Selangor, Malaysia

^bFaculty of Economics and Management,
Universiti Putra Malaysia, 43400 UPM Serdang Selangor, Malaysia

^cFaculty of Management,
Multimedia University, Persiaran Multimedia, 63100 Cyberjaya Selangor Darul Ehsan,
Malaysia

^dCollege of Business Administration, University of Nebraska at Omaha, 6708 Pine Street,
Omaha, NE 68182, United States

^eSchool of Business and Economics, Loughborough University, Leicestershire, LE11 3TU,
United Kingdom

Abstract

This study presents a nonlinear pass-through from the exchange rate to domestic prices drawn from a dataset of six Asian countries. Using the Markov-switching model, it is found that there are two regimes. The extent of the pass-through is incomplete and is found to be significantly lower in stable regime states. Domestic prices are sensitive to external factors when inflation uncertainty is higher. Essentially, the pass-through estimates exhibit some variation across countries and regimes. Central banks are credible, but the exchange rate is ineffective as a shock absorber during the unstable regime. We find that the output gap has more influence on inflation when the level of inflation exhibits large and erratic variations. Policymakers need to pay attention during periods of high inflation because consumer prices respond differently when the economy is in a high compared to a low inflation regime.

Keywords: exchange rate pass-through, inflation, shock absorber, structural breaks

JEL Classification: E31, F31, G01

* Corresponding author. *E-mail:* baharumshah@yahoo.com. Tel: +603-8946 7597.

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