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Author: SaangJoon Baak

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Is the yen misaligned more during the Abenomics period?

SaangJoon Baak

Professor

School of International Liberal Studies

Waseda University, 1-6-1 Nishi-Waseda, Shinjuku-ku, Tokyo 169-8050, Japan

Email: baak@waseda.jp

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Highlights

Is the yen misaligned more during the Abenomics period?

- We estimate the BEER model of the Japanese real effective exchange rate (REER).
- The misalignments of the Japanese REER are computed based on the estimation results.
- The yen was substantially overvalued during the global financial crisis period.
- The yen was undervalued during the Abenomics period.
- The yen was much less misaligned during the Abenomics period than in pre-Abenomics periods.

Abstract

This paper measures the extent to which the real effective exchange rate of the Japanese yen is misaligned from its equilibrium value. The equilibrium value is estimated using the behavioral equilibrium exchange rate (BEER) approach to determine whether the yen is more misaligned during the Abenomics period. Economic fundamentals such as terms of trade, relative price of nontraded to traded goods, net foreign asset ratio over trade volume, and real interest rate differentials are used to assess the equilibrium exchange rate. Because parameter instability is detected for the whole period (1993 Q1 to 2016 Q2), stable estimation results for the subsample period (2003 Q1 to 2016 Q2) are used to compute misalignments. The results indicate that the yen was substantially overvalued during the global financial crisis period (2008 Q4 to 2012 Q4). In contrast, it was undervalued during the Abenomics period

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