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Title	Exchange Rates and Fundamentals: A General Equilibrium Exploration
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Abstract	Engel and West (2005) claim that the observed near random-walk behavior of nominal exchange rates is an equilibrium outcome of a present-value model of a partial equilibrium asset approach when economic fundamentals follow exogenous first-order integrated processes and the discount factor approaches one. Subsequent empirical studies further confirm this proposition by estimating discount factors close to one under distinct identification schemes. In this paper, I argue that the unit market discount factor creates a theoretical trade-off within a neoclassical, two-country, incomplete-market monetary model; on the one hand, the unit discount factor generates near random-walk nominal exchange rates, while, on the other hand, it counterfactually implies perfect consumption risk sharing as well as flat money demand. Bayesian posterior simulation exercises based on post-Bretton Woods data from Canada and the United States reveal difficulties in reconciling the equilibrium random-walk proposition within the canonical model; in particular, the market discount factor is identified as being much smaller than one.
Keywords	Exchange rate, Present-value model, Economic fundamental, Random walk, Two-country model, Incomplete market, Cointegrated TFPs, Perfect risk sharing
JEL	E31, E37, and F41
