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This is a working paper and the author would welcome any comments on the present text. Citations should refer to an unpublished manuscript, mentioning the author and the date of issuance by the International Monetary Fund. The views expressed are those of the author and do not necessarily represent those of the Fund.

January 8, 1987

**Subject: Real and Monetary Factors in the Joint Determination of
the Exchange Rate and the Interest Rate**

The working paper circulated yesterday as WP/87/1 should have been numbered WP/86/17.

A corrected title page is attached.

Att: (1)

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WP/86/17

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Research Department

Real and Monetary Factors in the Joint Determination
of the Exchange Rate and the Interest Rate

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Authorized for Distribution by Malcolm Knight

December 30, 1986

Abstract

The paper analyzes the joint determination of the exchange rate and the interest rate in terms of the stochastic structure of underlying real and monetary factors. It argues that the information contained in the covariation of the exchange rate and the interest rate, as two variables that respond to the same economic disturbances, can be used to infer the nature of those disturbances underlying exchange rate determination. A statistically significant correlation between the exchange rate and the interest rate is shown to be inconsistent with the stochastic structure of underlying disturbances implied by the strictly random walk property of the exchange rate.

^{1/} The author thanks Charles Adams, W. Max Corden, Jeffrey A. Frankel, Malcolm Knight and S. Ramachandran for useful comments on an earlier draft of the paper, although he alone is responsible for the views expressed, and for any remaining errors.

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