



Real Interest Rate Parity for East Asian Countries Based on China with Two Structural Breaks

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ABSTRACT

This study applies Narayan and Popp's (2010) unit-root test with two endogenous breaks, which has been proven to be more powerful than the other unit root tests with two breaks (Narayan and Popp, 2013) to test the validity of long-run real interest rate parity (RIRP) to assess the non-stationary properties of the real interest rate convergence relative to China for ten East Asian countries. We examine the validity of RIRP from the perspective of the unit root with two breaks and provide robust evidence, which clearly indicate that RIRP holds true for six countries. Our findings point out their real interest rate convergence is mean reversion towards RIRP equilibrium values with two structural breaks. It implies that the choices and effectiveness of the monetary and fiscal policies in the East Asian economies will be highly influenced by external factors originating from China. Our results have important policy implications for these East Asian countries under study.