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THE CREST OF THE XIMB

The lamp on the book stands for the spread of knowledge, the chimney for industrial development, the two plants for rural development and the IHS logo for the Jesuit Society which manages the institute.

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Contents

Global Crude Oil Price and Exchange Rate Co-movements in Emerging Asian Economies*

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Abstract

The present paper endeavours to analyze the effect of variances in global crude oil prices on nominal exchange rate of major oil importing Asian economies namely, China, India, Hong Kong, Singapore and Japan. The paper employs GARCH specification models to evaluate the empirical relationship among the given variables. The investigation uncovers the negative effect of global crude oil price return on exchange rate of given Asian currencies against the U.S. Dollar. The study also established the asymmetric effect of oil price shocks in terms of degree on exchange rate volatility. The shocks in oil price having a lasting impact on variability in exchange rate can also be very well witnessed. The study clearly displays the phenomenon of transfer of fortune from nations dependent upon oil import to oil exporting nations. The outcome of the study has implications not only for policymakers but also for investors for risk management.

Key words: GARCH, Crude oil price fluctuations, Nominal exchange rate, Asian economies. JEL: E44, G14, G15

Introduction

Oil as the most major source of energy is termed to be one of the significant determinants of global economic performance. The fluctuation in global crude oil price has a substantial impact on the cost of production of goods and services in an economy and eventually influences the price levels. Since the oil price shock of 1970, the dynamics of crude oil price and its impact on various parameters of economic performance of any nation has attracted interest from academicians, researchers, economists, policy makers and businesses. The research in this area was mainly triggered by early studies of Hamilton (1983) and Darby (1982) who postulated that 70s and 80s recession can be significantly attributed to large increase in oil prices.

Owing to the fact that U.S. Dollar (U.S.D) is the widely accepted currency for billing and payment in the international oil markets, U.S. Dollar exchange rate becomes the key channel through which instabilities in global crude oil price is transferred to the real economy and financial markets (Reboredo, 2012). This makes the inter temporal

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