

Economics W4505

International Monetary Theory and Policy

Spring 2010

Homework 7

Due April 1 in class

Using Country Premia to Analyze Capital Mobility

Suppose you are working as an analyst in a bank and are asked to write a short report on the degree of capital mobility in China. Your assistant has assembled for you data for this assignment (see the spreadsheet Measuring Capital Mobility in China.xls). The data should be weekly from 12/11/1998 to 4/7/2006. Column B reports the 3-month forward rate (Yuan per USD), Columns C and D report annualized interest rates in China and the U.S., respectively, and Column E gives the spot exchange rate.

Construct the covered interest-rate differential (or country premium) in percent per year. Make a plot displaying time on the horizontal axis and the covered interest-rate differential on the vertical axis. Also, compute the mean, median, and standard deviation of the covered interest-rate differential. Use these elements to discuss the degree of capital mobility in China. Suppose further that you have some doubts whether the data your assistant assembled is correct. Therefore, take a look at the BIS Working Paper No 233, “Do China’s capital controls still bind? Implications for monetary autonomy and capital liberalisation” by Guonan Ma and Robert N McCauley, August 2007. Discuss to which extent your findings coincide with the findings regarding the degree of capital mobility reported in that paper. Be as specific as possible in your comparison of your findings to those reported in the BIS report. You should be explicit about exactly which table/figure you are comparing to and why those tables figures show data that is comparable to your data. What do you conclude about the dataset you have, does it appear to be correct. Why or why not.