The Common Trend and Transitory Dynamics In Real Exchange Rate Fluctuations
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This study explores the sources of real exchange rate fluctuations under the current float. Using a cointegration model of the real exchange rate, the innovations are decomposed into transitory and common trend components. Both transitory and common trend innovations are found to explain an appreciable portion of real exchange rate fluctuations, albeit their relative importance can vary across major currencies. Further analysis suggests that common trend innovations are attributable to both productivity and monetary changes, albeit transitory innovations are linked primarily to monetary changes. The empirical results are largely consistent with an open economy macroeconomic model.

JEL: F31, F41
Key Words: Real exchange rate; common trend; productivity shock; monetary shock
Words: 7199
Covariance's Matrix,