

Asset prices, Tobin's Q, and the real exchange rate

BOWDEN Roger J.

Returns on real capital assets such as equities or houses have often had a closer empirical concordance with real exchange rates than have interest rates. To explain why, this paper locates the source of inter run asset price rises in disequilibrium constraints on desired capital adjustment, manifested in asset prices via a Tobin's Q effect. The same effects alter the balance between non traded and traded goods and services prices, appearing as changes in the real exchange rate. Returns on real assets therefore have a signal value: they convey direct information about structural components of real exchange rate movements, in a way that interest rates cannot. The intermediate run disequilibrium elements can be smoothly annealed into the longer run path of the real exchange rate.
