

Global risk factors and their impacts on interest rates and exchange rates: evidence from ASEAN+4 economies

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Abstract

The international finance trilemma highlights the trade-off among exchange rate stability, monetary policy autonomy, and free capital flows, resulting in varied reactions to global risk factors among Asian economies. This study explores how various monetary policy objectives shape the diverse responses of Asian interest rates and exchange rates to global risk factors. Using the Structural Vector Autoregressive Model with Exogenous Variables (SVARX), we analyze the impulse responses of short-term interest rates and exchange rates to global risk factors, including the US monetary policy changes, global economic policy and financial risks, and oil prices. The main findings are as follows: First, we found that most of the Asian monetary authorities except Japan mirror the US monetary policy changes, showing the premier policy objective to stabilize their cross-border capital flows and exchange rates. The magnitude of mirroring depends on countries' exchange rate regimes. Furthermore, although global economic policy and financial risks trigger the depreciation of most of the Asian exchange rates, their influence on Asian short-term interest rates is relatively smaller, showing the limited influence of global risk appetite on monetary policy objectives. Last, we found the opposite responses of Asian interest rates and exchange rates to oil prices, showing the diverse economic effects of oil prices on oil export and import countries.

Keywords: international financial trilemma, global risk factors, monetary policy, exchange rate, Asian economies

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