

# Purchasing Power Parity and Real Exchange Rate: Evidence from Japan<sup>\*</sup>

Dara LONG<sup>†</sup>

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## Abstract

This paper examines the validity of both the short-run and long-run purchasing power parity (PPP) hypotheses in the case of the Yen-Dollar exchange rate using two estimation methods, namely, a unit root test and an Autoregressive Distributed Lag (ARDL) cointegration test. Some important findings are obtained from our analysis. The first test reveals the mean reversion of real exchange rate (RER) in the long-run. From the second test, we found that there is a strongly robust long-run PPP relationship but no significant short-run PPP relationship. Furthermore, unlike the previous literature, we use CUSUM and CUSUMSQ stability tests and rolling estimations to deal with the problems of structural breaks and power of the test respectively. Overall, the results suggest that PPP hypothesis in the case of Yen-Dollar exchange rate strongly holds in the long-run but not in the short-run.

**JEL classification:** C22, F31, F41

**Keywords:** PPP, Real Exchange Rate, Unit Root, ARDL to cointegration

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† Graduate School of Economics, Osaka University. Address: 1-7, Machikaneyama, Toyonaka, Osaka 560-0043, Japan. E-mail: hge017ld@mail2.econ.osaka-u.ac.jp; longdara@gmail.com