Title: The Link between Economic Growth and the Real Exchange Rate - the Role of the Nontradable Sector –

Name: Ken MIYAJIMA

Affiliation: University of California, Los Angeles
Ph.D. Candidate
kmiyajim@ucla.edu

Address: 11811 Venice Blvd. Apt 235, Los Angeles, CA 90066, USA

Cell Phone: 1-310-383-6686

ABSTRACT:
This paper examines the role of the nontradable sector in the context of the Harrod-Balassa hypothesis in an empirical framework. The underlying assumption of the Harrod-Balassa hypothesis is that a country's productivity improvements is mainly driven by those in the tradable sector, because those in the nontradable sector were assumed to be stagnant. The productivity hypothesis predicts that the real exchange rate appreciates (depreciates) when productivity improvements in the tradable (nontradable) sector are higher than those in the nontradable (tradable) sector. Provided that the productivity hypothesis holds, strong GDP growth should be typically accompanied by real appreciation of exchange rates. However, notwithstanding the Harrod-Balassa hypothesis, the data suggest that the real exchange rate has appreciated only about half the time in the episodes of strong economic growth. Productivity improvements in neither sector were typically higher than those in the other sector. This paper demonstrates this numerically as a fact using productivity estimates. For this purpose, sectoral productivity growth are estimated using the Harberger two-deflator method (a version of growth accounting method) for 15 developed countries. In doing so, I also demonstrate that the productivity hypothesis holds by using both the static and dynamic OLS, while the results in the literature have been inconclusive. The results here are relevant to growing countries as they make predictions of their own real exchange rate.

JEL Classification: C22, F31, O24, O47