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Exchange Rate Shocks and Their Consequences in Pre-WWII Japan

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Abstract

Japan was one of the first countries to abandon the gold standard and one of a few to begin its recovery in 1932. This paper examines whether time-series data can confirm that yen depreciation stimulated the pre-WWII Japanese economy. Since the exchange rate policy was often specific to ruling parties or finance ministers, those changes can be identified as exchange rate shocks. Depreciation shocks were expansionary and the policy counterfactual that makes the response of real interest rates insignificant demonstrates that intertemporal substitutions powerfully worked. This paper also shows that Japan's recovery from the depression can be fully explained by the devaluation.

Keywords: exchange rate; real interest rate; intertemporal substitution; great depression.

JEL classification: E5, F3, F4

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