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Abstract

We propose a simple theoretical and empirical approach to differentiate between common and idiosyncratic exchange rate movements in 5 Latin-American economies: Brazil, Chile, Colombia, Mexico, and Peru. Our approach allows us to distinguish the effects on exchange rates of a regional exchange rate common factor and macroeconomic fundamentals differentials. The methodology and estimation strategy are suitable for both low and high frequency settings. We provide evidence that the regional common factor has a significant effect on the dynamics of the Latin-American exchange rates. In our estimations the relation between exchange rates and the common factor is contemporaneous and stable during the studied period.