

Session 4: Empirical evidence

PPP

1. The assumption of PPP yields reasonable predictions about exchange rate behaviour if
 - The time period under consideration is short.
 - Monetary policies are contradictory.
 - Price levels change by relatively large amounts.
2. What are the empirical findings concerning the PPP?
3. What are reasons for the failure of PPP?

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4. During the last twenty years, nominal interest rates have been significantly lower in Switzerland than in our neighbour countries, e.g. Germany. This fact is often called Swiss interest rate bonus ('Zinsbonus'). Which key concept could you use to give a simple explanation of the Swiss interest rate bonus vis-à-vis our neighbours? Were the underlying expectations satisfied?
5. How would you derive a testable equation of whether $f_t = E_t[e_{t+1}]$?

Empirical evidence of the three models of exchange-rate determination

6. Do you expect the structural models to have a better forecasting record in the short run or in the long run?
7. The fact that the random walk (RW) model outperforms the structural models from a forecasting point of view is not damaging to the latter because all asset prices are known to follow a RW.
8. What are the main empirical findings on the determination of the nominal exchange rate in the short-run, in the medium-run and in long-run?