



International Finance Discussion Papers: Exchange Rates and Fundamentals: A Generalization

By John H. Rogers

BiblioGov. Paperback. Book Condition: New. This item is printed on demand. Paperback. 50 pages. Dimensions: 9.7in. x 7.4in. x 0.1in. Exchange rates have raised the ire of economists for more than 20 years. The problem is that few, if any, exchange rate models are known to systematically beat a naive random walk in out of sample forecasts. Engel and West (2005) show that these failures can be explained by the standard-present value model (PVM) because it predicts random walk exchange rate dynamics if the discount factor approaches one and fundamentals have a unit root. This paper generalizes the Engel and West (EW) hypothesis to the larger class of open economy dynamic stochastic general equilibrium (DSGE) models. The EW hypothesis is shown to hold for a canonical open economy DSGE model. We show that all the predictions of the standard-PVM carry over to the DSGE-PVM. The DSGE-PVM also yields an unobserved components (UC) models that we estimate using Bayesian methods and a quarterly Canadian-U. S. sample. Bayesian model evaluation reveals that the data support a UC model that calibrates the discount factor to one implying the Canadian dollar-U. S. dollar exchange rate is a random walk dominated by permanent cross-country monetary and...



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