EMPIRICAL EXCHANGE RATE MODELS OF THE SEVENTIES

Do they fit out of sample?

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This study compares the out-of-sample forecasting accuracy of various structural and time series exchange rate models. We find that a random walk model performs as well as any estimated model at one to twelve month horizons for the dollar/pound, dollar/mark, dollar/yen and trade-weighted dollar exchange rates. The candidate structural models include the flexible-price (Frenkel–Bilson) and sticky-price (Dornbusch–Frankel) monetary models, and a sticky-price model which incorporates the current account (Hooper–Morton). The structural models perform poorly despite the fact that we base their forecasts on actual realized values of future explanatory variables.