

Irving Fisher and the UIP Puzzle

Authors: Rachel A.J. Campbell, Kees G. Koedijk, James R. Lothian
and Ronald J. Mahieu.

Abstract: In this paper we empirically verify much of the seminal work by Irving Fisher on uncovered interest parity, which he conducted over a century ago. Like Fisher, we find that the departures from UIP are connected to individual episodes in which errors surrounding exchange-rate expectations are persistent, but eventually transitory. We find considerable commonality in deviations from UIP and PPP, suggesting that both of these deviations are driven by a common factor. Using additional international parity conditions to model exchange rates, we find significant empirical evidence that deviations from UIP are almost entirely due to errors in forecasting exchange rates, rather than risk premia.