

The Continuing Puzzle of Short-Horizon Exchange Rate Forecasting

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Are structural models getting closer to being able to forecast exchange rates at short horizons? Here we argue that over-reliance on asymptotic test statistics in out-of-sample comparisons, misinterpretation of some tests, and failure to sufficiently check robustness to alternative time windows has led many studies to overstate even the relatively thin positive results that have been found. We find that by allowing for common shocks in our panel specification, we are able to generate some improvement, but even that improvement is not entirely robust to the forecast window, and much of the gain appears to come from non-structural rather than structural factors.