Department of Economics Dalhousie University

International Finance - Econ 3331

Assignment 4

Due date and time: 19 October 2011, 14:35

1. General instructions

This assignment is intended to apply in real world contexts several concepts we have learned in the course. Your answers to these assignment questions must reflect your individual work and knowledge. You **cannot** work in groups and share your findings with others.

You must follow the policy on *Academic Integrity* stated in the course syllabus and the *Style Guidelines* attached to Assignment 1. Answer the questions using an essay format with appropriate figures, tables and references: state your data sources in a note to each table and figure, and show or explain your calculations clearly. Your essay will be marked based on research, logic and organization, and analysis, as well as writing style appropriate for the level of this course (see the course website for the grade rubric). Your analysis, arguments and conclusions must be based on verifiable evidence.

Late assignments will be marked down by 10 percent per day.

2. Assignment

In this assignment, you are asked to forecast the bilateral exchange rate between the Canadian dollar and the U.S. dollar for two future dates: 18 November 2011, and 19 October 2012. Your forecasts must be Canadian dollar price of the U.S. dollar up to three decimal places.

In your answer first discuss three (3) different methods of prediction that you have learned in this course. Then, use two (2) of these methods (excluding the random walk hypothesis), and explain the reasons for choosing these two methods. Finally, pick the method that you deem the "best" for the short-run and the long-run prediction (not necessarily the same method).

There is **no** requirement to use econometric techniques—though I do not discourage anyone from using such techniques. You **cannot** use another person or firm's forecasts of exchange rates. You may, however, use professional forecasters' forecasts of other variables. For instance, commercial banks, and the Bank of Canada routinely publish and announce their forecasts of inflation and real GDP growth rate.

You must read the classic article by Meese and Rogoff (1983) for an analysis that should inspire you.

You must report your findings in an essay format. Your essay must have a title, and the following structure:

1. **Introduction:** The introduction must grab the attention of the reader, and state the purpose of your essay. See Turabian (2010, Chapters 6–8) for effective writing.
2. **Main body:** The main body of your essay should discuss your methods. There should be a table, which shows the current exchange rates, and the short run and long run forecasts for each method. You should show your preferred forecast value in bold in the table. In a note

to the table, briefly describe your methods. Discuss your results and *economic* reasoning for coming down with the preferred methods in detail.

3. **Conclusion:** The conclusion should synthesize your findings, and discuss their basic economic (policy) implications.

4. **Appendix:** Present one sample calculation for each method. Also, present your data sources and **raw** data in a single table (do **not** attach a computer printout from a database; put the data in your own table). Do not report more than 2 or 3 digits unless essential.

Maximum 3 double-spaced pages (plus maximum 2 page Appendix).

References

Meese, Richard A., and Kenneth Rogoff, 1983. Empirical exchange rate models of the seventies: Do they fit out of sample? *Journal of International Economics* 14, 3–24.

Turabian, Kate L., 2010. *Student's Guide to Writing College Papers.* University of Chicago Press, Chicago and London, 4 edn. Available at the Killam Library Reference Desk Collection.