

EMPIRICAL FINANCE (IB9Y60) PROJECT 2006-7

The project objectives are for you to:

- Test the Purchasing Power Parity (PPP) relationship between the UK and the US using appropriate econometric techniques.
- Interpret and write-up your results.

Suggested project structure

1. Introduction and overview
2. Brief discussion of the theory underlying PPP and previous empirical results.
3. Discussion of appropriate econometric techniques for testing PPP
4. Summary analysis of the data
5. Presentation and interpretation of the main results
6. Conclusions and directions for future research

References

Appendices

Use appendices for ancillary results (e.g., summary statistics, line graphs and output from misspecification tests) – use appendices judiciously.

Structure appendices clearly – be sure the reader can find results in appendices easily (and that they are cross-referenced in the main text).

Word limit: 2,500 – excluding any appendices

Data

The project data are in an *Eviews* workfile file **ppp_uk_us.wf1** which was sent to you in an email entitled: **IB9Y60 Project Data**. This file contains monthly data for the period January 1957 to February 2006 (590 observations) relating to:

- The nominal exchange rate (**s**) (units of sterling per US dollar).
- A UK Wholesale Price Index (**p**).
- A US Wholesale Price Index (**pstar**).

Reading

Brooks (2002). *Introductory econometrics for finance*. (Chapter 7)

Cuthbertson and Nitzsche (2004). *Quantitative financial economics: stocks, bonds and foreign exchange*. (Chapter 24)

IB9Y6. Lectures 7, 8 and 9. Handouts for Seminars 6/7 and 8.

Applied Financial Economics, Special Issue: Purchasing Power Parity and Real Exchange Rates, Vol. 16, Numbers 1-2, 1 & 15th January 2006

This issue is available from the ground floor of the library or can be downloaded from the library web-page (under e-resources/journal then search for 'Applied Financial Economics'). The following articles in this issue are particularly relevant:

Mark P. Taylor, Real exchange rates and purchasing power parity: mean reversion in economic thought, pp 1-17 (provides an excellent review of theoretical and empirical issues relating to PPP)

Mohammad S Hasan, A century of Purchasing Power Parity: evidence from Canada and Australia, pp 145-156 (a good example of an empirical application using long memory and cointegration tests)

Additional information

Use the Harvard system for citation and referencing (see: www.go.warwick.ac.uk/lib-guides; click on the link to 'guide to bibliographic citation and referencing').

The main text of the project should be double-spaced.

The reference section should be single spaced.

The entire project should be printed using one side of A4 per page.

This project is worth 20% of the total module assessment.

The project deadline is Thursday 17th May, 2007.

However, if you have completed the project before this date, then an earlier submission would be appreciated.

Stuart Fraser, March 2007.