

# **Measuring the euro exchange rate risk premium: the conditional international CAPM approach**

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This paper derives measures for the bilateral euro exchange rate risk premia vis-a-vis the US dollar and the UK pound sterling as well as the US and the UK equity market risk premia using the perspective of a European investor. We carry out the estimations applying the conditional International Capital Asset Pricing Model (ICAPM). The ICAPM is estimated for both constant and time-varying prices of risk, using weekly data on the equity and foreign exchange returns for Europe, the UK and the US. In estimating the time-varying prices of risk, we propose a new set of instrumental variables that take both business cycle and market volatility considerations into account. Consequently, our risk premium estimates are very clear and intuitive, picking up most of the individual events that moved the markets relevant for European investors between 1986 and 2002.

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