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**Exchange rates and Markov switching dynamics**

This exercise presents a systematic and extensive empirical study on the presence of Markov switching dynamics in three dollar-based exchange rates. A Monte Carlo approach is adopted to circumvent the statistical inference problem inherent to the test of regime switching behavior. Two data frequencies, two sample periods, and various specifications are considered. Quarterly data yields inconclusive evidence - the test rejects neither random walk nor Markov switching. Monthly data, on the other hand, offer an unambiguous evidence of the presence of Markov switching dynamics. The results suggest that data frequency, in addition to sample size, is crucial for determining the number of regimes.

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