

# Uncovered interest parity tests and exchange rate expectations

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Empirical tests of uncovered interest parity or forward rate unbiasedness usually yield coefficients smaller than one, the theoretically implied value under the assumption of rational expectations. Experiments with an artificial foreign exchange market in this paper show that there is a relationship between the prevailing expectations mechanism and the sign and size of the UIP-test-coefficient. Markets with bandwagon expectations yield positive coefficients, while distributed lag expectations lead to negative coefficients. Regressive expectations are most likely to generate positive coefficients. Adaptive expectations tend to exhibit positive coefficients when traders adapt their expectations slowly and yield negative coefficients when learning increases.

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