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A rank approach for studying cross-currency bases and the covered interest rate parity

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AUTHOR OR EDITOR Daniel Ordoñez Jose Eduardo Gomez Santiago Gomez Luis Fernando Melo
AUTHORS AND/OR EDITORS Daniel Ordoñez Santiago Gomez

We use the recently developed panel rank-cointegration test proposed by Pedroni et al. [2015] to check for the stability conditions of the cross-country money market interest rate bases. Using weekly information on short-term interest rates and spot and forward exchange rates for a set of 20 European economies during 2005-2017, we show that in most cases these bases are non-stationary, implying the failure of the Covered Interest Rate Parity condition. Concretely, a mean-reverting behavior is encountered in only two cases. The first includes Greece, Italy and Portugal, while the second Belgium, France and Germany.

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