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A Simple Test of Momentum in Foreign Exchange Markets

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A Simple Test of Momentum in Foreign Exchange Markets A Simple Test of Momentum in Foreign Exchange Markets* Andrés Felipe García-Suaza**
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jgomezgo@banrep.gov.co Abstract This study proposes a new method for testing for the presence of momentum in nominal exchange rates, using a probabilistic approach. We illustrate our methodology estimating a binary response model using information on local currency / US dollar exchange rates of eight emerging economies. After controlling for important variables affecting the behavior of exchange rates in the short-run, we show evidence of exchange rate inertia; in other words, we find that exchange rate momentum is a common feature in this group of emerging economies, and thus foreign exchange traders participating in these markets are able to make excess returns by following technical analysis strategies. We find that the presence of momentum is asymmetric, being stronger in moments of currency depreciation than of appreciation. This behavior may be associated with central bank intervention. Keywords: Momentum, foreign exchange markets, hazard duration analysis, emerging economies. JEL Classification: G14, G15, C41 *Disclaimer: The findings, recommendations, interpretations and conclusions expressed in this paper are those of the authors and not necessarily reflect the view of the Banco de la República or its Board of Directors, or the Department of Economics of the Universidad del Rosario. ** Assistant Professor, Economics Department, Universidad del Rosario. Calle 14 #4-69, Bogotá, Colombia. *** Senior Research Economist, Banco de la República (Central Bank of Colombia).Carrera 7 # 14-78 Piso 11, Bogotá, Colombia.

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