



INSTITUT TEKNOLOGI MARA

**THE FORWARD RATE AS AN UNBIASED PREDICTOR
OF THE FUTURE SPOT RATE**

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If you gift me a fish, I will eat it today....but if you teach me how to fish, and I will eat it for the rest of my life.

ABSTRACT

The foreign exchange market makes possible payments from one country to another. Because of its importance, it is not surprising to find numerous studies which examined the ability to predict future spot rates. Under unbiased forward rate hypothesis(UFH), the forward rate in foreign exchange markets is considered an unbiased predictor of the future spot rate. Studies by Edwards(1982, 1983), Kohlhagen(1975), Longworth(1981), and Cornell(1977) have supported the unbiased future rate hypothesis. A simple linear regression is used to examine the relationship between forward exchange rate and the future spot rate. The hypothesis testing involved and observation of 30-days, 90-days, and 120-days forward exchange rate from four countries namely Germany, Hong Kong, Malaysia and Singapore. Results of the study periods demonstrate that null hypothesis of the unbiasedness of the forward rate is rejected for some nations but is retained for others. The notions of the study reveals that forward rate for Singapore currency is highly significant and potray the trend of the future spot rate. It is also followed by Deutsche Mark(Germany) . On the other hand, Hong Kong dollars is not significant, while, Malaysian ringgit shows inconsistent in predicting the trend of the future spot rate. The possible reasons for forward rate failed to anticipate the correct trend of the future spot rate comprised of two reasons. Firstly, the exchange markets are being bombarded with new information, which will provoke changes not only in exchange rate trends, but also in exchange rate expectations. Secondly, is that there is a possibility of official intervention in the short-term money markets, sometimes will prevent the forecasting of forward exchange rate to violate from fully reflecting exchange rate expectations. Thus, the predictive ability of forward rate is somewhat should not be regard as no better than the toss of coin.

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