

Title: Assessing the Forecastability of ESTAR Models: Evidence from ringgit/yen Rate

Authors: Ahmad Zubaidi Baharumshah^a, Venus Khim-Sen Liew^{a,b} and Evan Lau^c

Affiliations: ^a Department of Economics, Faculty of Economics and Management, Universiti Putra Malaysia, Malaysia.

^b Labuan School of International Business and Finance, Universiti Malaysia Sabah, Malaysia.

^c Faculty of Economics and Business, Universiti Malaysia Sarawak, Malaysia.

Abstract: The purpose of this paper is to contribute to the debate on the relevance of nonlinear forecasts in the financial markets. To that end, this study forecasts the yen-based ringgit by using the Exponential Smooth Transition Autoregressive (ESTAR) model. When formally assessed for forecast accuracy, the results reveal that the ESTAR out-of-sample predictors statistically outperform both the linear AR and random walk models at standard significant levels. The hypothesis of equal forecasting accuracy between ESTAR models and the random walk model is formally rejected based on the Fisher sign test. This paper offers some evidence on the ability to forecast exchange rates using nonlinear methods. Hence, we conclude that linear models are not always the optimal for forecasting exchange rate as there is some forecast accuracy that can be gained by considering the nonlinearity inherent in the exchange rate.

Corresponding author:

Venus Khim-Sen Liew

Lecturer

Labuan School of International Business & Finance,

Universiti Malaysia Sabah,

P.O.Box 80594, 87015 Labuan, Malaysia.

Tel: +6087460486

Fax: +6087460477

E-mail: venusliew@yahoo.com