



UNIVERSITY OF NAIROBI
SCHOOL OF MATHEMATICS

TITLE: THE LINK BETWEEN EXCHANGE RATES AND INTEREST RATES

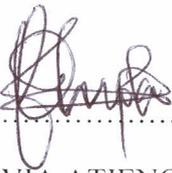
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DECLARATION

This project is my own work and has not been presented in any other University.

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This project has been submitted with my approval as a University Supervisor.

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ABSTRACT

In recent years, there has been a special interest in the link between exchange rates and interest rates in both advanced and developing countries. This is understandable, given the important role these variables play in determining developments in the nominal and real sides of the economy, including the behaviour of domestic inflation, real output, exports and imports.

The general view of the economics profession is that we cannot explain exchange rate movements. However, some researchers still contend that the relationship between real interest rate and real exchange rate is a useful framework for thinking about exchange rate movements. Meese(1990); Edison and Pauls(1991)'s results showed that exchange rates and interest rates, both nominal and real are nonstationary; however, they are not co-integrated with each other. Their final conclusion was that the empirical results do not confirm the relationship.

This paper seeks to find out whether such a link exists between interest rates and exchange rates.