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Uncertainty aversion in a heterogeneous agent model of foreign exchange rate formation.
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Summary: This paper provides what we believe to be the first empirical test of whether investors in the foreign exchange market are uncertainty averse. We do this using a heterogeneous agents model in which fundamentalist and chartist beliefs of the exchange rate co-exist and are allowed to be either uncertainty neutral or uncertainty averse. Uncertainty aversion is modelled using the maxmin expected utility approach. We find significant evidence of uncertainty aversion in the FX market where in particular fundamentalists are found to be largely uncertainty neutral while chartists are mainly uncertainty averse. Inclusion of uncertainty averse agents significantly improves the empirical performance of the model.

MSC:
91G80 Financial applications of other theories
91B64 Macroeconomic theory (monetary models, models of taxation)
91B69 Heterogeneous agent models

Keywords:
uncertainty aversion; exchange rate formation; heterogeneous agents

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References: