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Confidence Intervals for Half-Life Deviations From Purchasing Power Parity

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Abstract

Existing point estimates of half-life deviations from purchasing power parity (PPP), around 3–5 years, suggest that the speed of convergence is extremely slow. This article assesses the degree of uncertainty around these point estimates by using local-to-unity asymptotic theory to construct confidence intervals that are robust to high persistence in small samples. The empirical evidence suggests that the lower bound of the confidence interval is between four and eight quarters for most currencies, which is not inconsistent with traditional price-stickiness explanations. However, the upper bounds are infinity for all currencies, so we cannot provide conclusive evidence in favor of PPP either.

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