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Interest parity, purchasing power parity, "risk premia," and Post Keynesian economic analysis

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Abstract

This paper explores the implications for open economy macroeconomic analysis of the "cambist" approach to the forward exchanges, put forward by Lavoie (2000) and others. It argues that logically the counterpart to the rejection of any domestic natural rate of interest must also be the rejection of the idea that the real exchange rate is primarily determined by nonmonetary factors such as the supposedly immutable barter terms of trade. The real exchange rate is an endogenous monetary variable and is therefore subject in principle to manipulation by public policy. Much depends on the nature and determinants of the currency risk premium, in an environment in which separate monetary systems in different economies continue to exist, and which is characterized by *imperfect asset substitutability*, whether or not there is also *perfect capital mobility*.

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