

# UNCOVERED INTEREST RATE PARITY: EVIDENCE FROM ASIAN FRONTIER FINANCIAL MARKETS

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The purpose of this research is to examine the validity of the Uncovered Interest rate Parity (UIP) theory in the Asian Frontier Financial Markets. UIP theory states that, under rational expectations, the rate of depreciation of local currency should be precisely equal to the difference between the domestic and the foreign-risk free interest rate. This research examines the validity of the UIP condition in both long run and short run dynamics applying the Autoregressive Distributed Lag cointegration approach (ARDL) using three countries (Sri Lanka, Vietnam, and Bangladesh) categorized under the Asian Frontier Financial Markets. Optimum lag order is observed using all possible Goodness of fit tests and maximum 8 lags. Results shows that Exchange rate returns has a positive impact on Interest rate in both long and short run dynamics for Sri Lanka, Bangladesh, and Vietnam.

**Keywords:** *Uncovered interest rate parity; Exchange rate differential; Autoregressive distributed Lag; Interest rate differential*

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