

Erratum for
The Quanto Theory of Exchange Rates

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We wish to correct a minor error in our paper, “The Quanto Theory of Exchange Rates.” The caption of Figure 3, and the surrounding text, incorrectly identifies the plotted time series as “Expected currency appreciation . . . as measured by ECA”. Instead the figure shows the *quanto-implied risk premium* (QRP), which differs from ECA by the interest rate differential (IRD).

The corrected figure, plotting the variables corresponding to the original caption, is shown below. Happily, the discussion in the paper and the central message of the figure are unaffected by the distinction between ECA and QRP. In particular, our main interest was in the size and sign of the gaps between the two lines in each of the panels. As the transformation from QRP to ECA involves a level shift by IRD, these gaps are essentially identical in the corrected figure and in the published version.¹

We apologize for the error, and we are grateful to Mike Chernov for pointing it out to us.

¹They are essentially, as opposed to exactly, identical because we define IRD as a ratio, rather than a difference, of gross interest rates.

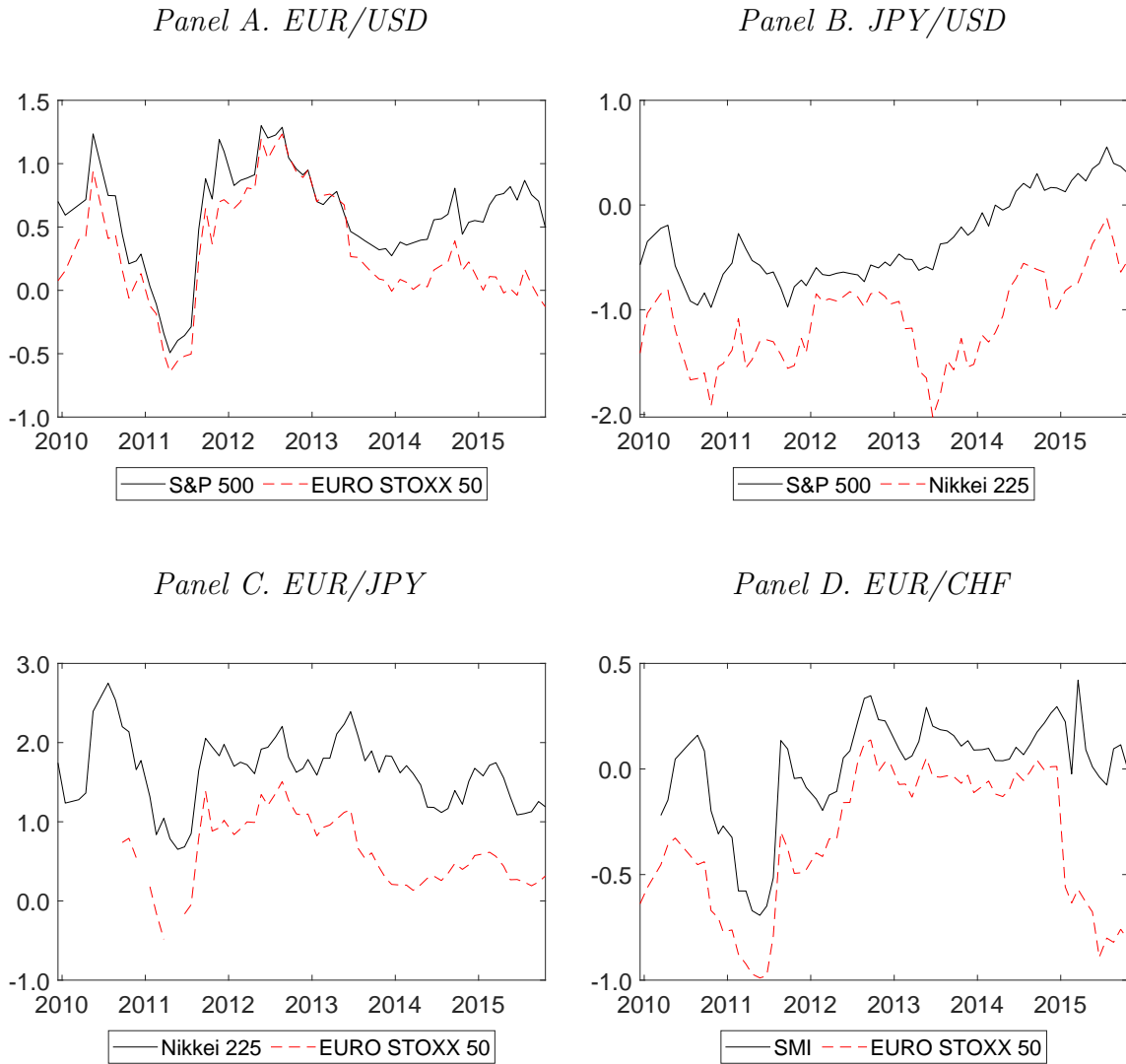


Figure 3 (corrected): Expected currency appreciation over a 24-month horizon (annualized), as measured by ECA from equation (14), for the EUR/USD, JPY/USD, EUR/JPY, and EUR/CHF currency pairs. Each panel plots ECA for the respective currency pair from the two national perspectives, using quanto contracts on the respective domestic index denominated in the respective foreign currency. The solid line plots ECA as perceived by a log investor fully invested in the S&P 500 (top two panels), Nikkei 225 (bottom left panel), and SMI (bottom right panel), respectively. The dashed line plots the negative of ECA for the same currency pair (inverting the exchange rate) from the perspective of a log investor fully invested in the respective foreign equity index.