

This thesis provides out-of-sample forecast of Czech Crown to Euro exchange rate using the vector autoregressive model. We select inflation, output, unemployment and interest rate as the fundamental economic variables interacting with the exchange rate in the ten-year period from 1999 through 2008. As our analysis concentrates on the short-term horizon, we measure the performance of our estimates for 2009 against the benchmark of the naive random walk approach.

Surprisingly, for our data the VAR model outperforms the normally distributed white noise significantly. We conclude that the main reason is the systematic and steady appreciation of the Czech Crown during the observed period, which cannot be captured by random walk. This shows that econometric approximation of exchange rate fluctuations can be meaningful even in the short-term horizons.