# Expected Currency Returns*

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## Abstract

We study the term structure of expected risk premia and risk preferences in foreign exchange (FX) markets. We first show theoretically that we can extract a utility-free measure of risk preferences and then estimate this measure using expected excess returns from professional forecasters and expected risk premia implied from option prices. We find that investor preferences reflect a strong aversion to high-order risk, thus departing from the log utility framework considered by Kremens and Martin (2019). Also, unconditionally, the term structure of risk preferences is downward-sloping. Conditionally, the slope of term structure becomes even more negative in bad times but it is upward-sloping in good times. Hence, fear of high-order risk is greater in the shorter term during bad times, but greater in the longer term during good times. We thus provide novel insights on the conditional term structure of risk preferences.



*Keywords:* Exchange rate, predictability, risk premium, consensus forecast, Quanto, growth optimal portfolio.

*JEL Classification*: F31, F37, F47, G12, G15.