represents p/e. If purchasing power parity offers an accurate portrayal of relative prices, then p/e is an unbiased estimate of $p*$.[11] Deviations are then normally distributed with zero mean. Estimates of α^2 correspond to the variance of the monthly deviations.

Over the period 1980-1994, the value of p/e is biased downward. This finding suggests that prices in the United States (adjusted for currency value) are greater than Canadian prices. In other words, travel spending by Canadians would be relatively more expensive than goods purchased domestically. We also find that $\bar{p}$ is a more accurate forecast and that $\bar{p}$ is consistently above p/e. Consequently, consumers should rely more heavily on $\bar{p}$ rather than p/e in forming foreign price expectations. That is, the behavior of the measures of uncertainty associated with the two forecasts are such that consumers should attach greater weight to $\bar{p}$ in constructing expected values of U.S. prices.

4.2 Estimates of the Model

In this section, we estimate a linear model to determine the influence of the

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[11] Whether nominal exchange rates adjust to equate prices across countries is highly debated (see, e.g. Rogoff 1996). Overall, the law of one price appears better suited to explain long-run exchange rate movements. In the short run, deviations from the law of one price are well documented and may be attributed to such factors such as the goods are not the same (Richardson 1978), transportation costs, trade barriers, and pricing-to-market behavior (Knetter 1993).
Recent work for Canada and the United States offers evidence that borders do matter, contrary to the law of one price. McCallum (1995) and Engel and Rogers (1996) find significant effects of the Canadian-U.S. border on regional trade patterns and commodity prices.