Real Effective Exchange Rates – The BIS methodology and beyond

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Real effective exchange rates (REERs) provide a single measure of relative prices for a given country. The paper overviews various methodologies to assess relative prices across countries: from nominal bilateral exchange rates, through bilateral real exchange rates, to nominal effective exchange rates and REERs. It shows that the calculation of REERs depends crucially on three factors: 1) country coverage, 2) deflator choice and 3) trade weights. The paper details the key trade-offs these factors involve. In particular, it provides an example how one can, for instance, use the consumer price index (CPI) based BIS REER to calculate unit labour cost (ULC) based REER consistently. The paper concludes that different policy questions might require using different REERs. Furthermore, a solid understanding of the three main trade-offs is crucial for policymaking.

Key words: real effective exchange rates, consumer price index, unit labour costs, competitiveness