

Alternative measures of Real Effective Exchange Rate: A Different Story on Price Competitiveness?

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Abstract

The purpose of the paper is to illustrate the importance of the REER calculation in making the inference for the price competitiveness of the economy. Despite the same essence of the calculations used worldwide, there are still many differences with respect to the treatment of the relative prices, selection of the weighting criterion and its time variation, third markets competition, etc. Hence, all these elements could be country-specific. Within the paper, new alternative measures of REER of the Denar are calculated. First, we calculate new measure by changing the country weights in line with the strong recent changes in the trade directions and the structure of the economy. Second, due to the large weight of primary commodities in the Macedonian trade, we calculate alternative measure where these products are excluded when defining country weights. Finally, we try to see the effect of different deflators, and for this purpose an alternative measure using ULC as relative price is calculated. The paper presents the differences among the alternative measures, and how they affect the overall assessment of the price competitiveness of the country. There is no straight answer to the question of which measure of the REER is the best, and when analyzing, the selection of the measure depends upon the economic issue being analyzed.

Key Words: Nominal effective exchange rate, relative prices.