

The effects of transit trade on measuring real effective exchange rates

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Abstract

Effective exchange rates (EERs) are attracting increasing attention as a measure of international competitiveness. Trade weights are one of the factors used in the calculation of these indicators. Hence, the quality of trade data influences the behaviour of EERs. This paper aims to adjust for the effects of “transit trade” on the weights used in the calculation of the EERs of the euro. We analyse these effects using data on the total trade of euro area countries vis-à-vis their trading partners. As trade data are not harmonised across sources, we assess the quality of different data sources and fine-tune the calculation of the trade weight data underlying the EERs accordingly. We conclude that our adjustments slightly decrease the overall euro EER trade weights of other European non-euro area countries and somewhat increase the weights of Asian and American countries. However, the impact of these changes on the overall trade weights is minimal in terms of the behaviour of the real EERs of the euro.

Keywords: Competitiveness, effective exchange rates (EERs), trade weights