Effective Exchange Rate Compilation Methodology in the NBS

Monetary Policy Department, NBS

Milan Gylánik

Abstract

The main aim of the paper Effective Exchange Rate Compilation Methodology in the NBS is to describe the updated methodology used for NEER and REER computation, and to justify changes comparing to the previously applied procedure. At first the selection of relevant trading partners of Slovakia is explained through the territorial structure of foreign trade turnover in manufacturing goods that results in weights used for bilateral nominal or real exchange rates aggregation into the effective exchange rate indices. Next part refers to the sources of input data represented by bilateral exchange rates of the domestic currency to the relevant trading partners currencies, and both the domestic and foreign inflation indicators. There follows the description of a formula that uses the above mentioned weights and input data for effective exchange rate compilation. The resulting nominal effective exchange rate and real effective exchange rates for slovak economy based on CPI, PPI, PPI-manufacturing, ULC and ULC-manufacturing are presented in the form of base indices and their annual changes in the paper. The results originating from the updated methodology are compared to the effective exchange rates obtained using the weights of the same trading partners selection based on total slovak foreign trade turnover or double weights according to the ECB methodology, to the output from the original NBS methodology, and to the effective exchange rates published for Slovakia by several international institutions. This comparison is realised in the form of charts and correlations of the effective exchange rates development obtained from alternative sources with export in order to evaluate their ability to indicate domestic producers competitiveness. The main improvements of the updated methodology consist of the slovak foreign trade increased coverage through the new extended relevant trading partners selection and the capturing of changing foreign trade territorial structure using the variable weights. These changes led to an increased correlation of effective exchange rates based on the updated methodology with export dynamics. Utilisation of the variable weights and a lag in the publication of foreign trade structure information necessitate regular effective exchange rates data revisions for the last two years.

Full paper in Slovak:
http://www.nbs.sk/_img/Documents/PUBLIK/MU/MetodikaEER.pdf