

# **What is behind the real appreciation of the accession countries' currencies ? An investigation of the PPI based real exchange rate**

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Our investigation focuses on the development of the PPI-based real exchange rate. This makes it possible to abstract from increases in the relative price of non-tradables along the lines of the Balassa-Samuelson model, which is reasonable as such increases in the relative price of non-tradables have no impact on the economy's competitiveness and the sustainability of the current account position. The analysis therefore differs from most of the existing investigations of the real exchange rate of transition countries, such as e.g. Coricelli and Jazbec (2001), de Broeck and Slok (2001), Halpern and Wyplosz (2001), which concentrate on the impact of increases in non-tradable prices on the real exchange rate. Due to the focus on the PPI-based real exchange rate, our research also differs from investigations within the macroeconomic balance framework and which test the developments of the CPI-based real exchange rates (Frait and Komarek (1999), Filipozzi (2000), Egert (2002)). The framework of a macroeconomic model of the current account and the real exchange rate appears to be the most appropriate means for disentangling the factors that drive the real exchange rate and the equilibrium real exchange rate of transition and accession countries. It enables us to take into account that the determining factors are manifold and may have opposite effects on the exchange rate: export revenue, capital imports, government budget deficits, wage-induced inflation, real interest differential, and growth rates in the process of catching up. In this paper we aim to test the importance of the mentioned factors in the development of the real exchange rate towards the German mark and the euro for the countries that are most likely to enter ERM II within the next two years: the Czech Republic, Hungary and Poland.