

Catching up: the role of demand and supply side effects on the real exchange rates of accession countries

MACDONALD Ronald, WÓJCIK Cezary

The main aim of the paper is to examine the exchange rate behavior of a group of four transitional, EU accession countries, with a view to making policy recommendations regarding their accession to full European Monetary Union. We employ the dynamic panel ols estimator to investigate relative importance of demand and supply influences on the exchange rates of these countries. Our analysis show that although supply-side effects are likely to be important for the accession countries, it seems highly likely that demand side influences will also be important determinants of inflation differentials and, as we shall argue in this paper, such demand side effects are likely to have a deleterious effect on inflation and competitiveness. An additional focus of the paper is on examining the role that administrative prices and the productivity of the distribution sector play in real exchange rate dynamics in these countries. Based on a unique database we show that administrative prices have been a powerful force behind price and real exchange developments in these countries. The distribution sector has an independent effect on the internal price ration over-and-above that generated by BS effect.
