

Equilibrium real exchange rate model of Armenia

2014-09-04

WP 08/07/01-E

Central Bank of Armenia
Working Paper

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Abstract

The equilibrium real exchange rate (ERER) is one of the key indicators for assessment of the state of economic development of a country. So it is of great importance to uncover the variables that influence on the RER and to forecast RER's future path. Like a very common technique used in the literature for developing and transition countries we also used cointegrating equations in form of a restricted single-equation model, as far as Armenia has short-run time series problem, which does not allow estimating the VEC model. After some econometric tests 4 variables out of 30 were found to have significant explaining impact on RER. They are current transfers as a ratio of GDP, capital inflow, government investments in GDP, and nominal effective exchange rate as short-run (only) variable. Thus, the only policy instrument which the authorities may use to effect the level of the ERER is government investments (perhaps also total government spending).

This model has enabled to estimate short-run and long-run real exchange rates, the adjustment paths to their equilibrium levels after external shocks, and it also observes the misalignments and explains the reasons of it. Besides it was used to assess the steady-state level of appreciation, which according to this model is estimated about 5.8 % per annum based on the developments of the last five years.

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