

Consultant's report on Master's Thesis

Equilibrium exchange rate: Effect of the degree of competition on the real equilibrium exchange rate – evidence from a panel of exporting companies

by Marie Raková

The thesis by Marie Raková deals with the topic of real equilibrium exchange rate and consists of two parts. The first part introduces various approaches to equilibrium exchange rate determination. The author describes several theories of exchange rate. She also explains the major empirical approaches that are used in estimating misalignments of exchange rate. The second part consists of the research that analyzes the effect of competition on real exchange rate. Author uses a unique data set on Czech exporting companies, estimates the impact of exchange rate on the change of relative prices in individual industries and compares this change with concentration indicators in individual industries. The result is that the industries with stronger degree of competition show smaller relative change of prices when the nominal exchange rate changes than the industries with weaker degree of competition. Based on the result of this empirical analysis and of the theoretical model, the author concludes that concentration has an effect on the change of relative prices, therefore on the observed real equilibrium exchange rate.

I think that the conducted empirical investigation is very well constructed and contains a number of valuable insights. It leads one to a natural conclusion about the necessity to control for competitiveness every time one has the ambition to derive implications for aggregate external (im)balance from sectoral price indices. From this point of view, the work deserves the highest possible esteem.

My objections refer to the generally poor discrimination made in the study between the macroeconomic concept of equilibrium currency value and the exchange rate passthrough in individual industries, which is microeconomic in nature. Although the title claims the contrary, the study *does not* express itself to the question of *equilibrium exchange rate determination*. Of course, this is no surprise at all given the poor reputation of existing attempts to define and analyze this concept. (Of which some impression is given by the

review in the paper itself, where main shortcomings of several frequently cited examples are mentioned.) Altogether, the descriptive part dedicated to UIP, REER, BEER, NATREX and other instances of unsuccessful economic thinking about fundamental exchange rate determinants appears insufficiently related to the main contribution of the author. It also suffers from giving too much attention to partially obsolete and insignificant examples from the literature: the actual state of thinking about both real and nominal exchange rate developments is elsewhere.

In spite of the mentioned “compositional” weaknesses, I recommend the highest grade for the own contribution that this work has made.

☆

Prague, 19 June 2006

Alexis Derviz