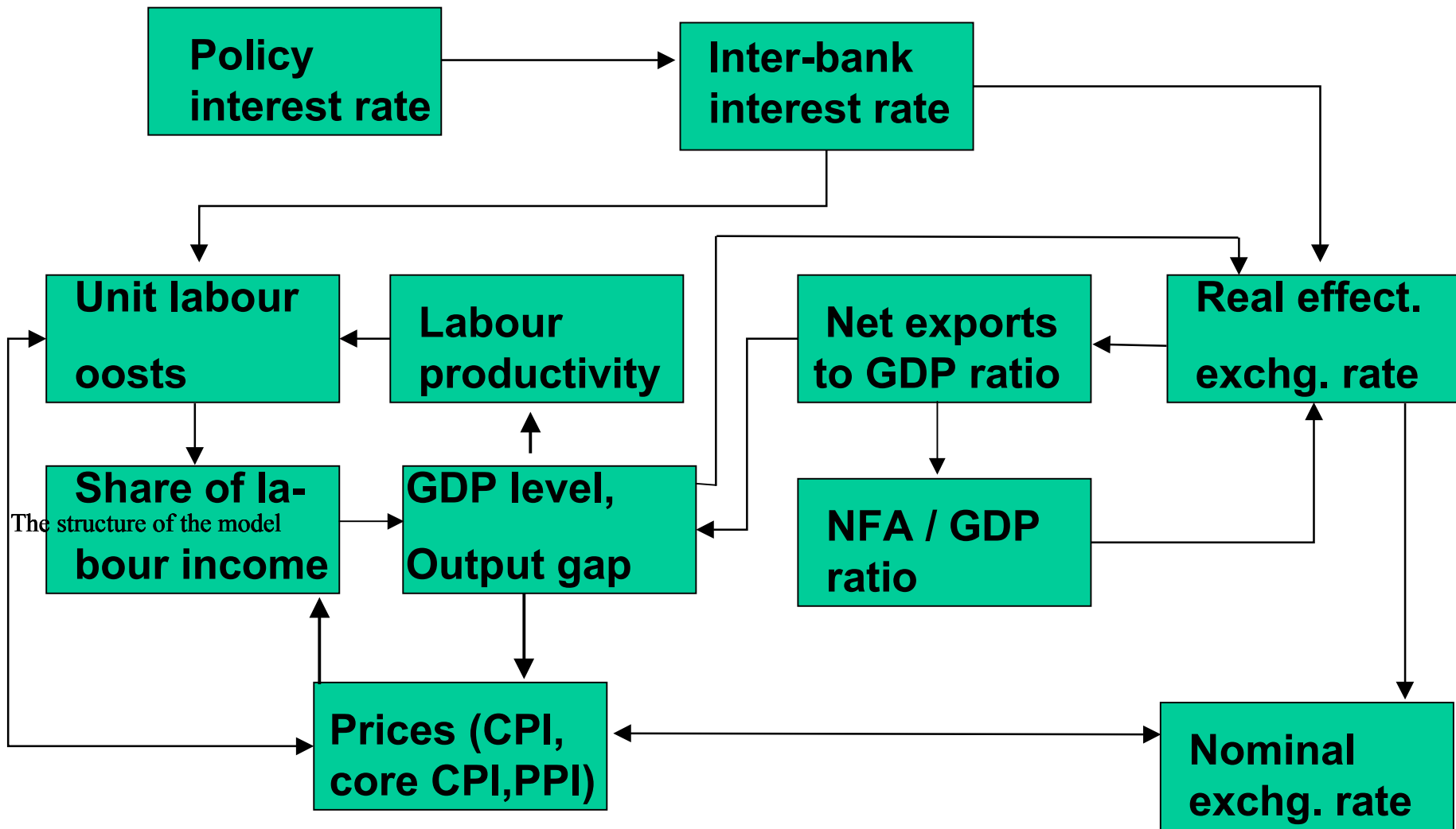


## Computing equilibrium exchange rate for Slovakia

- Model used: modified multi-equation structural model for inflation targeting
- Equilibrium exchange rate path as model forecast with specific properties:
  - **Non-negative output gap**
  - **Non-decreasing net foreign assets**
- **If potential output grows and the ability to export improves, there is space for moderate real appreciation up to 2010.**

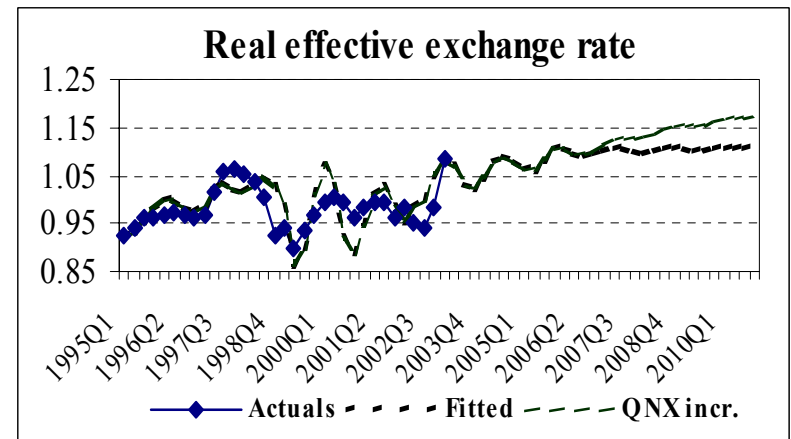
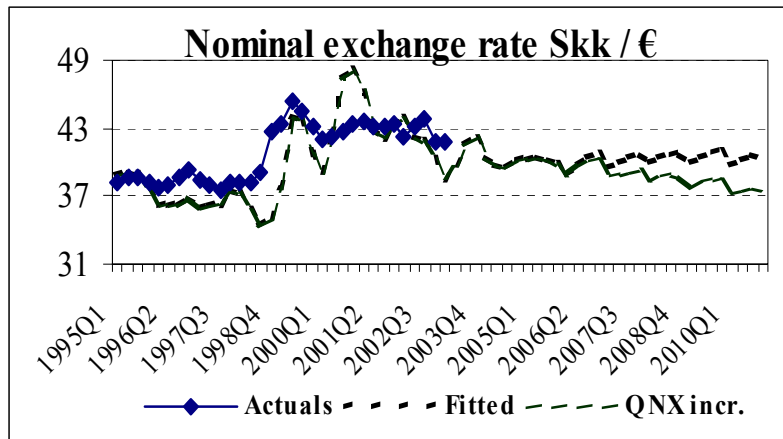
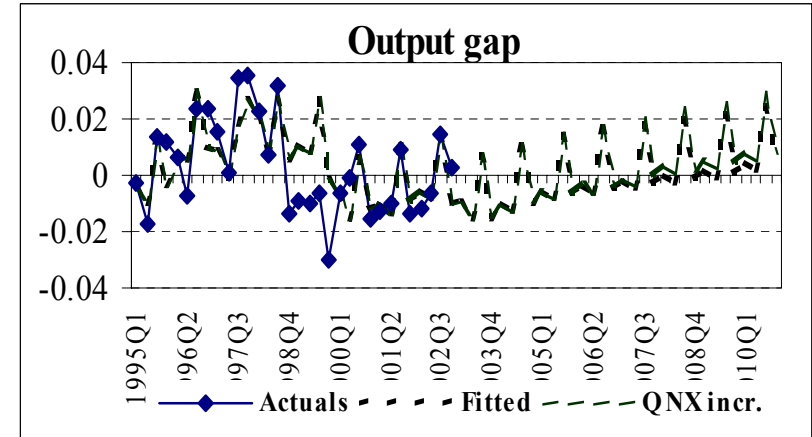
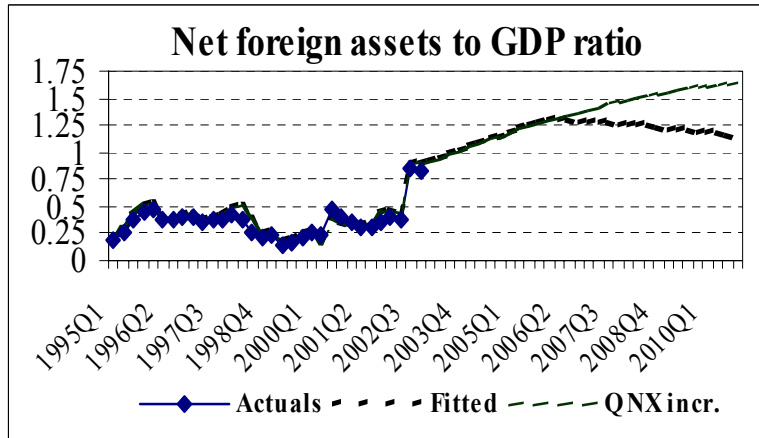
## **Behavioral relations of the model:**

- Forward-looking Philips curve
- Modified UIP condition (dependent variable is real effective exchange rate), similar to BEER approach
- Equation for share of net export on GDP
- Equation for output and output gap
- Equation for unit labor costs (backward looking) containing also interest rate
- Equation for labor productivity

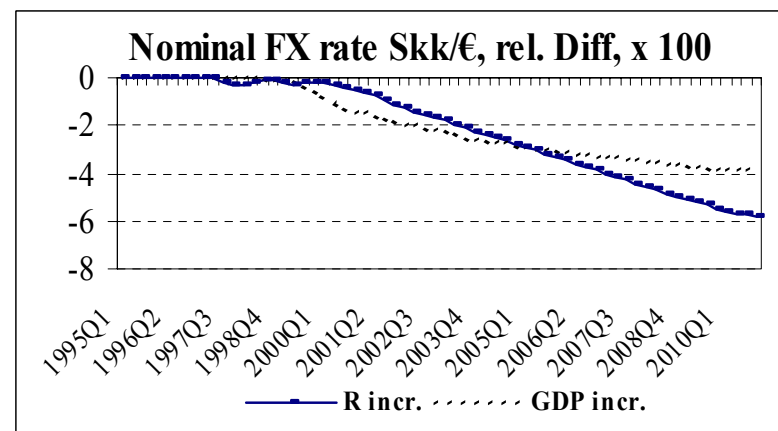
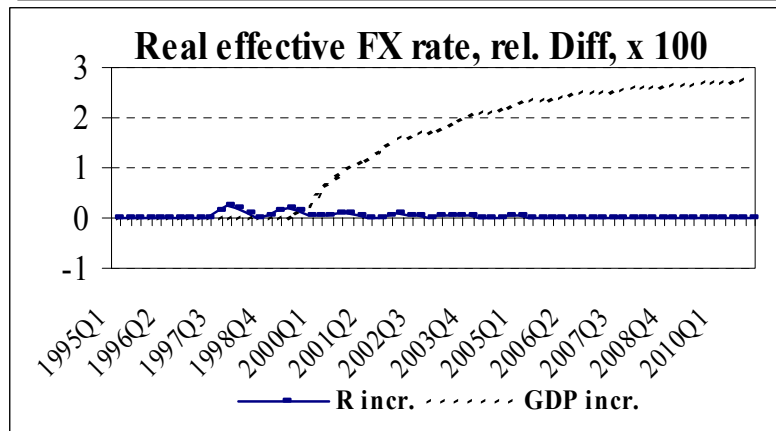
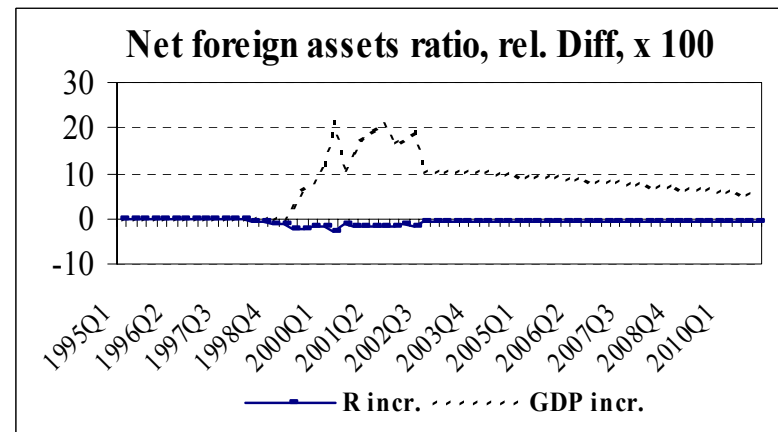
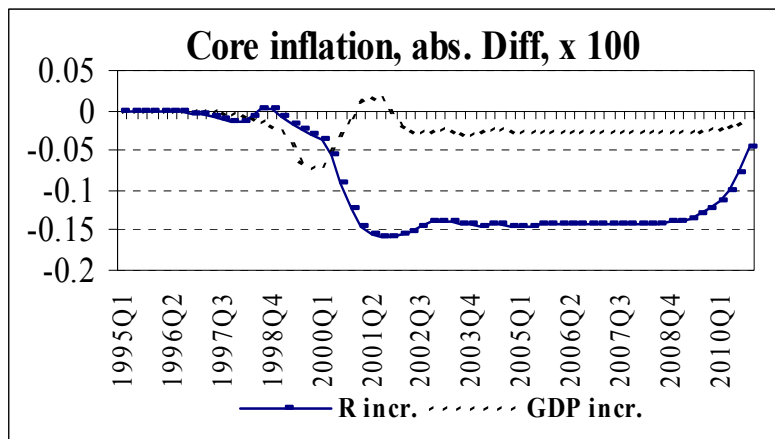


## THE STRUCTURE OF THE MODEL

# Unadjusted and adjusted forecast



# Deviations form standard run



# Conclusions:

- Although the (equilibrium) real exchange rate is a function of the relative economic performance of the two countries, measured by GDP, *both faster GDP growth and better net export performance* are required for real appreciation
- The changes of interest rate have only marginal effects on real economy in Slovakia.
- The real convergence is rather a complementary goal to the nominal convergence than a substitute goal. The presented model allows computing paths for different assumptions about the supply side of the economy, as the second alternative scenario showed. In fact, these factors may be the main determinants of the optimal path of exchange rate in the convergence process