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# ARGUMENTS FOR AND AGAINST RETAINING EXCHANGE RATE REGIME: AN EMPIRICAL ANALYSIS FOR REPUBLIC OF MACEDONIA

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## ABSTRACT

*The selection and management of the exchange rate regime are an important aspect for an economy in order to preserve competitiveness, macroeconomic stability and growth. The selection of a particular exchange rate regime which is consistent with the economic interests of the country depends on various factors. Therefore , there is no single exchange rate regime which is perfect and suitable for all countries. The choice of a range of regimes depend of relative weight that arises from different factors. The appropriate exchange rate regime will be modified over time according changes in country's circumstances. Taking in view the case of Macedonia and the aspiration to be part of EU, Exchange rate regime can improve the situation of Macedonia only if the access to a large extent makes Macedonia location from which foreign investors can serve to the EU market. Also with the support of estimations, in this paper we showed that in a small and open economy such as Macedonia, using the exchange rate as an instrument could be realized the opportunity for growth of export performances, increasing aggregate demand and increasing economic growth, thus investigating the the arguments for and against retaining exchange rate regime which was the focus of this paper.In this paper we focus on Republic of Macedonia, as a small and open economy, i.e. the arguments for and against retaining exchange rate regime.(The last sentence should be deleted in my opinion its already mention in the sentence before).*



**Keywords:** Exchange rate, Nominal effective exchange rate, VECM, Macroeconomic aggregates, Cointegration, Republic of Macedonia.

**JEL Classification:** F4.

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$\log neer_t$ and $\log m2_t$ (0.8982), $\log neer_t$ and $\log m4_t$ (0.2872).[2] The autocorrelation is of particular importance in the analysis of time series and it is not a problem in any of the models. The models have a problem with normality in the residuals but it is not a big problem to be reviewed the results obtained with our models.

## 5. CONCLUSION

From the presented estimation starting with VECM, we recognize that 1 % increase in imports will cause an increase in the nominal effective exchange rate of 0.115 % . T – statistics which is less than 1.65 indicates that between GDP and nominal effective exchange rate there is no cointegration. Further, 1 % increase in interest rates will cause a reduction of nominal effective exchange rate of 0.2 % ; 1 % increase in exports will cause a decrease in nominal effective exchange rate of 0.119 % ; 1 % increase in purchasing power parity will cause a reduction in nominal effective exchange rate of 0.155 % .When the focus is on real exchange rate, 1% increase in real exchange rate will cause reduction in nominal effective exchange rate of 0.341%. 1% increase in inflation leads to an increase in nominal effective exchange rate of 4,089%. For money supply M2, results show that 1% increase in the money supply M2 leads to reduction in the nominal effective exchange rate of 0,064%. According to results, we conclude that the cointegration relation of the nominal effective exchange rate is bilateral with following macroeconomic aggregates: interest rate, purchasing power parity, the real effective exchange rate (REER) and the monetary aggregate M2. The cointegration relation has direction from the nominal effective exchange rate to other macroeconomic aggregates only in the case of imports and inflation . In the case of monetary aggregate M4 and exports, causality moves from them to the nominal effective exchange rate. In the case of the GDP, the serie is not cointegrated with the nominal effective exchange rate .Robust tests confirmed that the model is well specified and can not reject the null hypothesis. Based on the results we can decide to favor long-term bilateral causal relationship. The series of short term are not statistically significant related to the short-term. However, researcher's conclusions about causality depends on the length of the sample, the number of explanatory variables (Lemos, 2004).

## REFERENCES

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[2] These p-values means that possibility to make Type 1 error to reject the null hypothesis that the restricted model is better than unrestricted model is high. When we have that in mind, this means that there is insufficient evidence to reject the null hypothesis.