A Few Minutes Series

Subject – Economy

Date – 23rd March 2023

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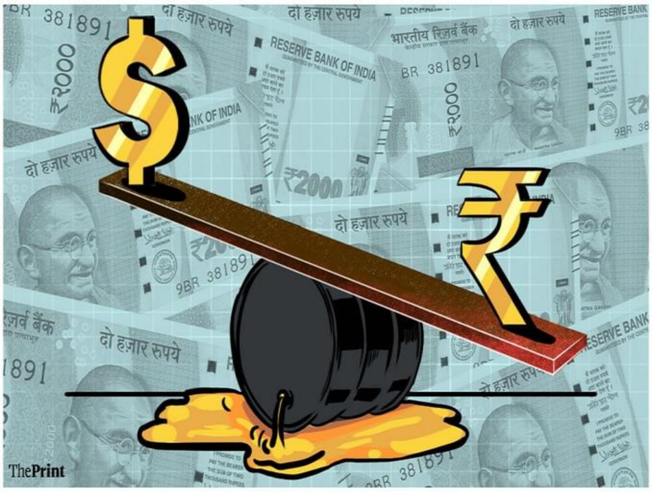
NEER and REER Explained



Significance

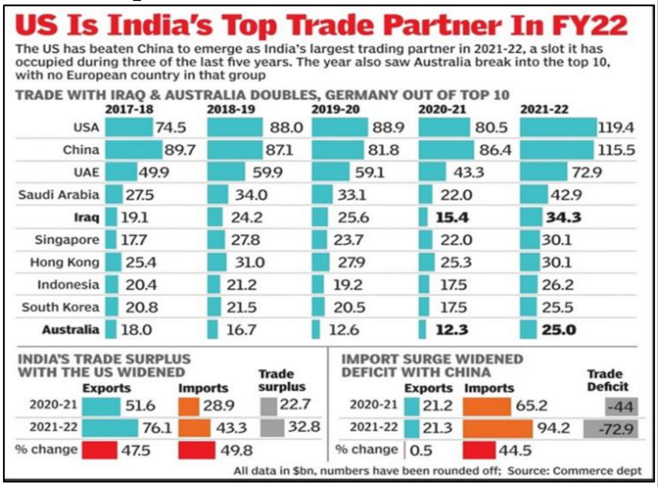
- **How many rupees are required to buy a US dollar.**

If Rupee Falls

- Costly Import & Competitive Export

Determination?

- Decided by the supply and demand for rupees and dollars



US Is India's Top Trade Partner In FY22

The US has beaten China to emerge as India's largest trading partner in 2021-22, a slot it has occupied during three of the last five years. The year also saw Australia break into the top 10, with no European country in that group

TRADE WITH IRAQ & AUSTRALIA DOUBLES, GERMANY OUT OF TOP 10

	2017-18	2018-19	2019-20	2020-21	2021-22
USA	74.5	88.0	88.9	80.5	119.4
China	89.7	87.1	81.8	86.4	115.5
UAE	49.9	59.9	59.1	43.3	72.9
Saudi Arabia	27.5	34.0	33.1	22.0	42.9
Iraq	19.1	24.2	25.6	15.4	34.3
Singapore	17.7	27.8	23.7	22.0	30.1
Hong Kong	25.4	31.0	27.9	25.3	30.1
Indonesia	20.4	21.2	19.2	17.5	26.2
South Korea	20.8	21.5	20.5	17.5	25.5
Australia	18.0	16.7	12.6	12.3	25.0

INDIA'S TRADE SURPLUS WITH THE US WIDENED

	Exports	Imports	Trade surplus
2020-21	51.6	28.9	22.7
2021-22	76.1	43.3	32.8
% change	47.5	49.8	

IMPORT SURGE WIDENED DEFICIT WITH CHINA

	Exports	Imports	Trade Deficit
2020-21	21.2	65.2	-44
2021-22	21.3	94.2	-72.9
% change	0.5	44.5	

All data in $bn, numbers have been rounded off; Source: Commerce dept

Effective Exchange Rate (EER)

- Summary of the movement indication of the domestic currency against a complete basket of other global currencies of its trading partners.
- Competitive the domestic currency is assessed as compared to the other currencies that the country trades with.

- **The NEER may be defined as a weighted average of one country's currency that is needed to purchase a foreign currency.**

Table 1: New 40-Currency NEER/REER Basket – Normalised Weights

(Per cent)

Country/Area	2015-16 Trade-based Weight	2015-16 Export-based Weight	2020-21 (P) Trade-based Weight	2020-21 (P) Export-based Weight
1. Euro Area	11.4	14.0	11.6	14.7
2. China	10.0	5.0	12.0	5.6
3. UAE	9.4	12.4	7.8	10.4
4. US	9.1	14.7	11.6	18.4
5. Saudi Arabia	6.4	4.1	4.4	2.1
6. Switzerland	3.7	0.5	2.7	0.4
7. Hong Kong	2.9	4.8	3.9	4.6
8. Indonesia	2.9	1.8	2.8	1.6
9. Singapore	2.8	4.4	3.2	3.7
10. Iraq	2.7	0.4	3.2	0.6

$$NEER = \prod_{i=1}^{n} (e/e_i)^{w_i}$$

NEER = $CER1^{Weight}$ *X* $CER2^{Weight}$ *X* $CER3^{Weight}$ *If Inflation in India increases as compared to its trading partners.*

It will result in high Prince Index Ratio

Which will eventually increase the Divergence between NEER and REER

Where CER is Currency Exchange Rate Weight is Weightage of Currency (40% = .4)

Example:

Country 1 ; CER =82 and Weight = 40%

Country 2 ; CER =60 and Weight = 40%

Country 3 ; CER =55 and Weight = 20%

NEER = 66.81

$$REER = \prod_{i=1}^{n} [(e/e_i)\ (P/P_i)]^{w_i}$$

- P and Pi represent price index of home country and price index for trade partner country
- **The REER, defined as a weighted average of nominal exchange rates adjusted for relative price differential between the domestic and foreign countries.**

REER = $X(PR2\ X\ CER2)^{Weight}$ *X (PR3 X* $CER3^{Weight}$*)*

- Where PR is Price index ratio (P/Pi)

<u>**REER**</u>

- Measures the health of a nation's currency against that of the countries it trades with and is an indicator of the international competitiveness of a nation.
- An increase in REER implies that exports become more expensive and imports become cheaper; therefore, an increase indicates a loss in trade competitiveness.

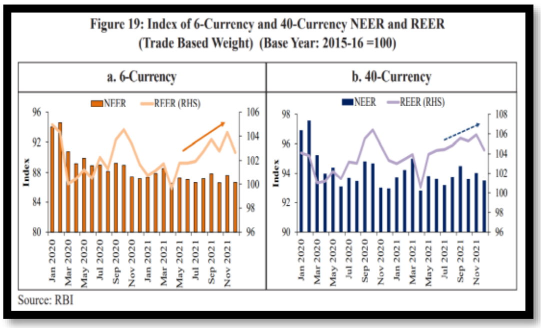


Figure 19: Index of 6-Currency and 40-Currency NEER and REER (Trade Based Weight) (Base Year: 2015-16 =100)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