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Purchasing Power Parity in economies in transition: evidence from Central and East European countries

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Abstract

The present study tests for the validity of long-run Purchasing Power Parity (PPP) for 17 European economies in transition. Analysis is performed following the methodological suggestions expressed in recent studies for PPP. Long-run PPP is initially tested for each economy vis-a-vis the USA, using the Johansen cointegration methodology and then for

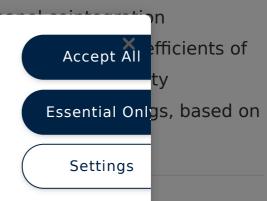
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I would like to thank Nikos Mylonidis, the editor of the present paper and an anonymous referee for helpful comments and suggestions. All remaining errors are entirely my responsibility.

Notes

 1 In this, the categorization of Froot and Rogoff (1995) is followed.

² Dibooglu and Kutan (<u>2001</u>) identify the impact of nominal shocks on the nominal and real exchange rates in Hungary and Poland; Suppel (<u>2003</u>) illustrates the important effect of real shocks to the real exchange rates of Poland, the Czech Republic and the Slovak Republic; Borghijs and Kuijs (<u>2004</u>) show that it is mainly nominal shocks, which have contributed significantly to nominal exchange rate variability in five CEE Countries (the Czech Republic, Hungary, Poland, the Slovak Republic and Slovenia).

³ Most of these papers find evidence for relative PPP but fail to support strong PPP.

- ⁴ See Taylor (<u>1988</u>), for the derivation of Equation <u>3</u> in a model allowing for transportation costs and measurement errors.
- ⁵ The panel cointegration analysis uses a common sample length for all countries.
- ⁶ Their diagnostic tests do not indicate any serious mis-specification (serial correlation and/or non-normality) problem. They are not reported here for space reasons but are available on request.

⁷They argue that in panel tests testing for the stationarity of real exchange rates, the non-stationarity hypothesis is rejected as a result of a few stationary real exchange rates in the panels. Still, alternative tests to overcome this problem turn out to be

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