

Exchange Rate Pass-Through and Foreign Exchange Policy

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Abstract

We explore the hypothesis of incomplete exchange rate pass-through to import prices, for the Hellenic economy, during the pre-EMU era 1975-1998. If that is true, “expenditure-switching” effects of exchange rate movements might be very small, while the so-called Marshall-Lerner-Robinson condition for the Balance of Trade adjustment could not hold. Consequently, the managed float of the Hellenic Drachma (GRD) by the Bank of Greece (BoG) would be inefficient in the external equilibrium target. In such partial equilibrium framework, we use the generic regression model proposed by Goldberg & Knetter (1997) and time series cointegration analysis initiated by Johansen (1988), for the major Hellenic bilateral trade, i.e., that against Germany, Italy, France and the United Kingdom, using quarterly data. The main empirical evidence, asking for further research, are: (a) The exchange rates found to be disconnected from the industrial production, translating no or very low substitution effects, which may justify a fixed exchange rate regime, (b) The long run pass-through coefficients which were estimated larger than one, in the three out of four cases, could justify the sliding GRD policy adopted by the BoG; however, the short run coefficients which were between 0.35 and 0.75 argue about the ineffectiveness of this managed float of the GRD.

Keywords: exchange rate pass-through, managed float, exchange rate regimes, exchange rate disconnect, producer vs local currency pricing (PCP vs LCP), small open economy, Hellenic Economy, EMU.

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