

ISTANBUL CONFERENCE ON ECONOMICS AND SOCIETY (ISTCES) 2025

*Pathways to Inclusive Growth: Overcoming Challenges in
Emerging and Developing African Countries.*

24-26 SEPTEMBER 2025

Book of Proceedings

Editors

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Prof. Dr. Muhittin Kaplan

Assist. Prof. Dr. Asad Ul Islam Khan

Assist. Prof. Dr. Ayman Bekirođlu

Assist. Prof. Dr. Arab Dahir Hasan

Ayuba Napari, PhD

Mohammed Muntaka Abdul Rahman, PhD

Mahat Maalim Ibrahim, PhD

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16.

Are Proxies of Balassa-Samuelson Effect Robust? Evidence from Developing Countries

Ahsan Shafique¹
Fatima El Morabit²

Exchange rate movements have started achieving a pivotal role in shaping economic expectations of a common man in today's world. These variations which once used to be regular oscillations between currencies in the world market have gradually become the real drivers of change of the macroeconomic fundamentals in every economy. On the one hand, the daily changes in these rates impact the consumption and investment decisions of the individuals while their deviation from a perceived rather calculated normal steers action from the governments on the other, in order to control other connected macroeconomic indicators including inflation, investment, exports, imports etc. The evidence suggests that no matter how deviated these the real exchange rates between two countries may be, there exist tacit drivers that pull them back to converge to a similar pattern over time to the least. Despite evidence on convergence of real exchange rates, the studies that aim to investigate the determinants of equilibrium exchange rate find scant or at least inconclusive evidence in favour of Balassa Samuelson hypothesis (and hence purchasing power parity) as being a determinant of real exchange rate (or equilibrium real exchange rate). The study investigates using broader evidence (and not a country specific case) that the convergence of real exchange rates between different countries emanates from the law of one price. This requires first, finding a relationship between real exchange rates and Balassa Samuelson proxies

1 School of Graduate Studies, Department of Economics, Ibn Haldun University, Türkiye ahsan.shafique@stu.ihu.edu.tr

2 Mohammed V University, Rabat, Morocco elmfatema.phd@gmail.com

and next between different proxies of BS and the relative sectoral productivities and in turn the price ratios of tradable to non-tradable goods. Evidence suggests that the higher relative price of non-tradables in the catching up economy leads to appreciation of its real exchange rate. Hence, this helps us establish the robust proxy(ies) for BS that reiterate the existence of BS hypothesis. Our sample includes six developing countries from different parts of the world namely, Pakistan, Türkiye, Nigeria, Malaysia, Indonesia and Thailand while the data pertaining to period 1981-2024 is used for evaluation and analysis. Evaluation uses panel data analysis techniques along with relatively new CS-DL (Cross Sectional Distributed Lag) approach. The results will help us determine the robust proxies of BS effect hence Equilibrium real exchange rate. This intern ensures precise calculation of REER misalignment, a key information for most policies pertaining to exchange rates.

Keywords: Exchange Rates, Balassa Samuelson, REER, EREER, Misalignment