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TESTING PURCHASING POWER PARITY IN ROMANIA

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ABSTRACT

This paper investigates if the theory of purchasing power parity (PPP) is valid for Romania and the EU countries. We use two different methodologies. The first one is a cointegration analysis of the Lei/Euro exchange rates, the Romanian Consumer Price Index and the EU Harmonized Consumer Price Index. The second implies testing the stationarity of the Lei/Euro real exchange rates. We find evidence to support the existence of a long run equilibrium relationship between exchange rates and price relatives, as the series enumerated above are proved to be cointegrated. However, we cannot confirm any of the PPP hypotheses, as none of the classical conditions of symmetry and proportionality of the coefficients of the price indices is satisfied.

JEL Classification: E31, F31, P24

Keywords: purchasing power parity, real exchange rate, cointegration, transition economies

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