NEER and REER

NEER and REER are indicators of external competitiveness. The Nominal Effective Exchange Rate (NEER), also known as the trade-weighted currency index, measures a nation's ability to compete in the global foreign exchange (forex) market. The Nominal Effective Exchange Rate (NEER) is adjusted for relative prices or costs to produce the real effective exchange rate (REER), which is reflected in inflation differences between the domestic economy and trading partners.

The article discusses the differences between trade-weighted indexes of REER and NEER in detail, focussing on their important aspects. The article also cites the difference between Nominal Effective Exchange Rate and Nominal Effective Exchange Rate, which is an important topic for the UPSC Exam.

NEER

The Nominal Effective Exchange Rate (NEER) is a weighted average exchange rate representing the nominal value of one country's currency relative to a basket of various foreign currencies. The amount of local currency required to buy foreign currency is known as the nominal exchange rate. The NEER measures a nation's ability to compete internationally in the foreign exchange (forex) market. The NEER is also known as the trade-weighted currency index by forex dealers.

The NEER may be modified to account for the difference between the inflation rates in the home country and its trading partners. The final number is the Nominal Effective Exchange Rate (REER). NEER isn't based on each currency's linkages in a nominal exchange rate individually. Instead, it illustrates how the value of one local currency contrasts with several different foreign currencies at once.

The Nominal Effective Exchange Rate can be calculated by the formula given below:

$$NEER = \prod_{i=1}^{n} \left(\frac{S_i}{S_i^*} \right)^{w_i}$$

n = number of countries from the basket

s_i = exchange rate of the national currency against the currency of the country i

s^*_i = exchange rate of the national currency against the currency of the country i during the base period

w_i = country's weight (of the currency) in the basket;

REER

The weighted average of a country's currency concerning an index or basket of other significant currencies is the Nominal Effective Exchange Rate (REER). The relative trade balance of each country's currency is compared to the trade balance of every other country in the index to establish the weights. An individual country's currency value about the other main currencies in the index is determined using this exchange rate.
The Nominal Effective Exchange Rate can be calculated by:

$$REER = \prod_{i=1}^{n} \left(\frac{s_i}{s_i^*} * \frac{p_i}{p_{MD}} \right)^{w_i}$$

n = number of countries from the basket

s_i = exchange rate of the national currency against the currency of the country i

s^*_i = exchange rate of the national currency against the currency of the country i during the base period

w_i = country's weight (of the currency) in the basket;

p_i = inflation rate in the country i

p_{MD} = inflation rate in the Republic of Moldova.

NEER vs REER

Indicators of external competitiveness include the Nominal Effective Exchange Rate (NEER) and Real Effective Exchange Rate (REER) indexes. The weighted average of the domestic currency's bilateral nominal exchange rates in relation to other currencies is known as NEER. The REER, conceptually related to the purchasing power parity (PPP) hypothesis, is defined as a weighted average of nominal exchange rates adjusted for relative price differences between domestic and foreign countries.

- The coverage of NEER/REER indexes for the new base year, i.e., 2015–16, has increased from 36 to 40 currencies due to changes in India's international trade pattern.
- Eight new nations—Angola, Chile, Ghana, Iraq, Nepal, Oman, Tanzania, and Ukraine—have been included in the 40-currency basket due to changes in the bilateral trade shares of the largest trading partners.
- Argentina, Pakistan, the Philippines, and Sweden are the nations that were removed from the previous 36-currency basket.
- 5.4 per cent of India's total merchandise trade was with newcomers, compared to 1.4 per cent with leaving nations.
- As a result, 88 per cent of India's overall commerce is represented by the new NEER/REER basket as opposed to 84 per cent for the 36-currency basket.

Difference Between Nominal Effective Exchange Rate & Real Effective Exchange Rate

The difference between REER and NEER are discussed in a tabular form below.

REER	NEER
It displays the home currency's adjusted value in relation to other significant trading currencies.	It displays how much the home currency is worth in relation to other currencies.
It eliminates the effects of currency-specific inflation differentials and concentrates solely on exchange rate differentials.	The difference in inflation rates between the country and its trading partners has an influence.
As a result of being corrected for inflation, it is thought to be a more accurate estimate.	Due to differences in inflation, it may provide measurements that aren't exactly precise.
This indicator is trade-weighted, and is determined using the NEER.	It is determined using a currency basket. This indicator is trade-weighted.