Q2

With reference to the Indian economy, consider the following statements: 1. An increase in Nominal Effective Exchange Rate (NEER) indicates the appreciation of rupee. 2. An increase in the Real Effective Exchange Rate (REER) indicates an improvement in trade competitiveness. 3. An increasing trend in domestic inflation relative to inflation in other countries is likely to cause an increasing divergence between NEER and REER. Which of the above statements are correct? (a) 1 and 2 only (b) 2 and 3 only (c) 1 and 3 only (d) 1, 2 and 3 Official key: C.

UPSC Civil Services Prelims 2022 · General Studies · 2 marks · Economy

Indian economy, budget, schemes - Prelims GS Paper I.

Explanation

(a)

1 and 2 only. REER up means the real exchange rate has appreciated - competitiveness worsens, not improves.

(b)

2 and 3 only. Statement 2 is false; 1 and 3 hold.

(c) Official key

1 and 3 only. NEER up = rupee appreciation. Higher home inflation vs partners widens REER minus NEER.

(d)

All three. Statement 2 reverses the REER-competitiveness link.

Summary

Official key is (c) 1 and 3 only. A rise in NEER is a nominal appreciation of the rupee. REER is NEER adjusted for relative prices; a higher REER is a real appreciation and weaker trade competitiveness. If India inflates faster than partners, REER rises relative to NEER - statement 3.

Related possible facts

These can be asked in a future Prelims paper.

NEER
Trade-weighted basket of bilateral nominal rates.

REER

NEER × relative price index; used as a competitiveness gauge.