



Comments on

External Balance Assessments

by Steve Phillips

Menzie D. Chinn

Robert M. La Follette School of Public Affairs
and Department of Economics
University of Wisconsin
and NBER

Analyzing (External) Imbalances

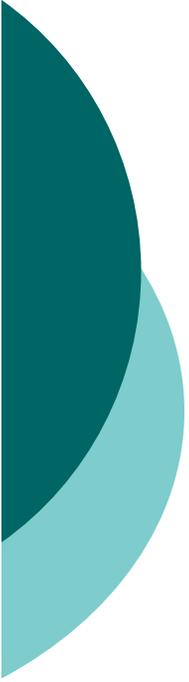
IMF, Washington, D.C.

February 2, 2012



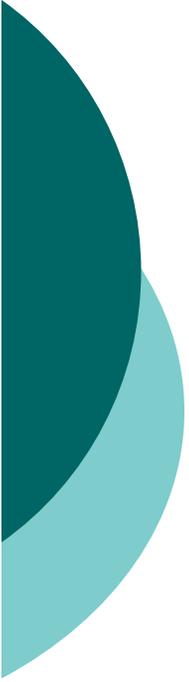
Aims of EBA

- Modeling current account balances with a clearer distinction between positive and normative aspects
- Making a clearer distinction between (traditional) structural and cyclical-exogenous, cyclical-policy influenced, and policies
- Identify CA components associated with “policy gaps”
- Modeling RER levels



Motivation

- An ambitious exercise
- But likely worthwhile
 - The previous CGER approach used a useful framework, but pieces added ad hoc, in response to specific needs
 - Took as given fiscal policy
 - The output was hard to explain



Key Issues in Implementation

- Interpreting External *and* Internal Balance in EBA
- Pooling across advanced and emerging market economies
- The no-dummies stricture
- Moving to the annual frequency



External and Internal Balance

- Previous CGER largely viewed external balance separate from internal balance
- EBA envisions inclusion of one conventional macro measure of internal balance (output gap)
- So an advance, but not sure how to interpret the coefficient



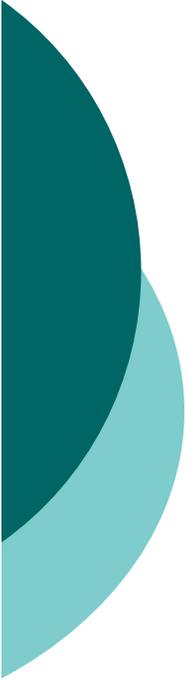
Pooling

- The authors pool data for 45 countries over 1986-2010
- Admirable to try to obtain one specification to fit all countries
- But in my experience, coefficients differ significantly across groups
- Contrast between in-sample tests that reject homogeneity and out-of-sample forecasting exercises that do better using panels



The No-Dummies Stricture

- I think this is an admirable goal as dummies are a reflection of our ignorance
- Here there is a tension between econometrics and economics
- No dummies for country groups, oil exporters, and crisis events
- (But dummy for safe haven currency to accommodate differential VOX effect)



Moving to the Annual Frequency

- Good idea! All time series econometricians suggest departing from time-averaged data – but challenging!
- EBA allows for differing short run dynamics (which is a good idea), via country-specific AR(1)
- Is an AR(1) sufficient? Probably yes, but US CA pre-2007 was indistinguishable from unit root
- Question of sensitivity of procedure to omitted slow-moving variables

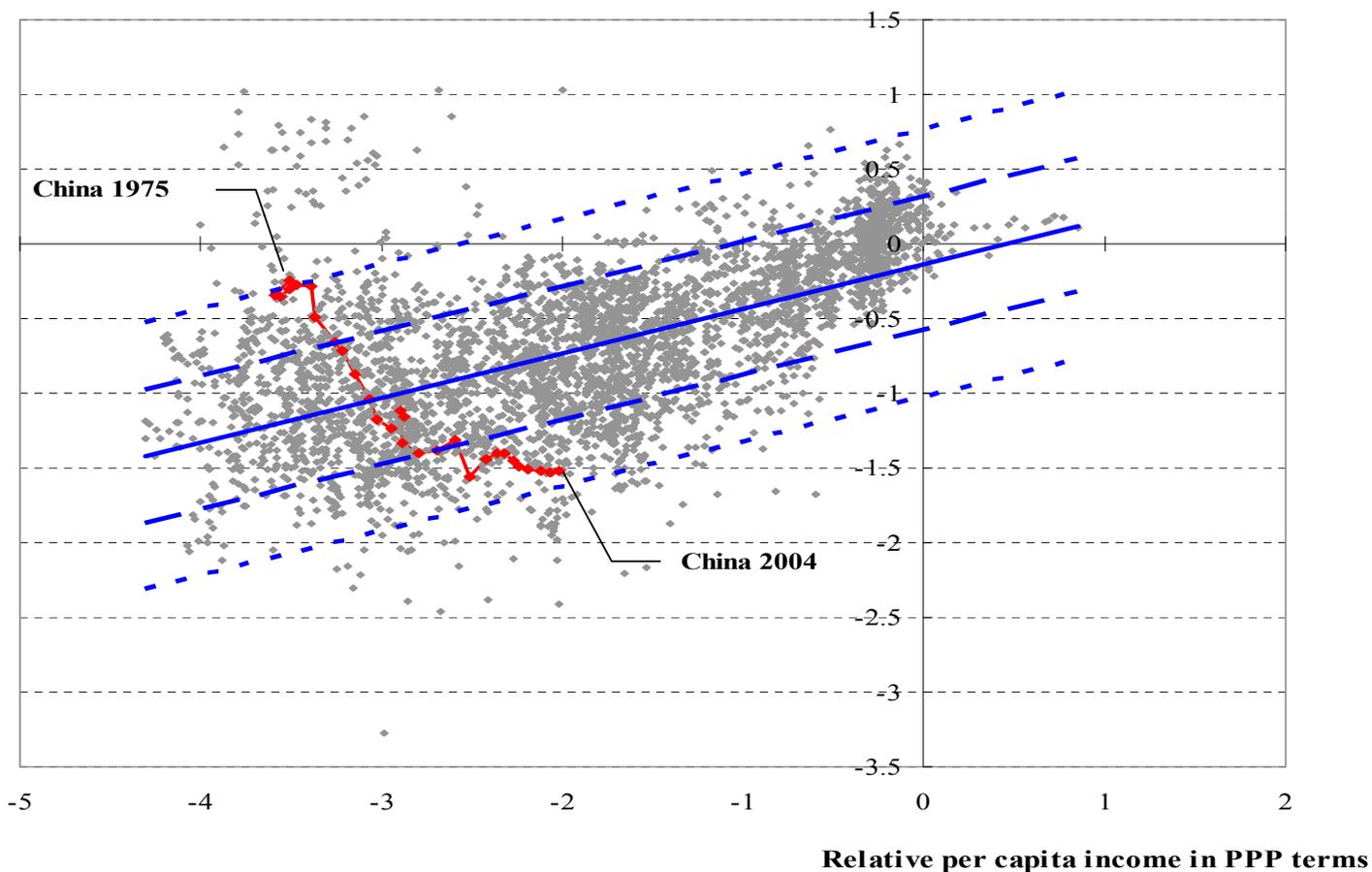


Exchange Rates in EBA

- Assessing exchange rate levels is a laudable goal
- Big, big problem with data (i.e., data revisions)
- Short run versus long run equilibrium (e.g., Dornbusch model – any level can be consistent with fundamentals and a given level of price stickiness)

Price – income (PPP), 2007 vintage

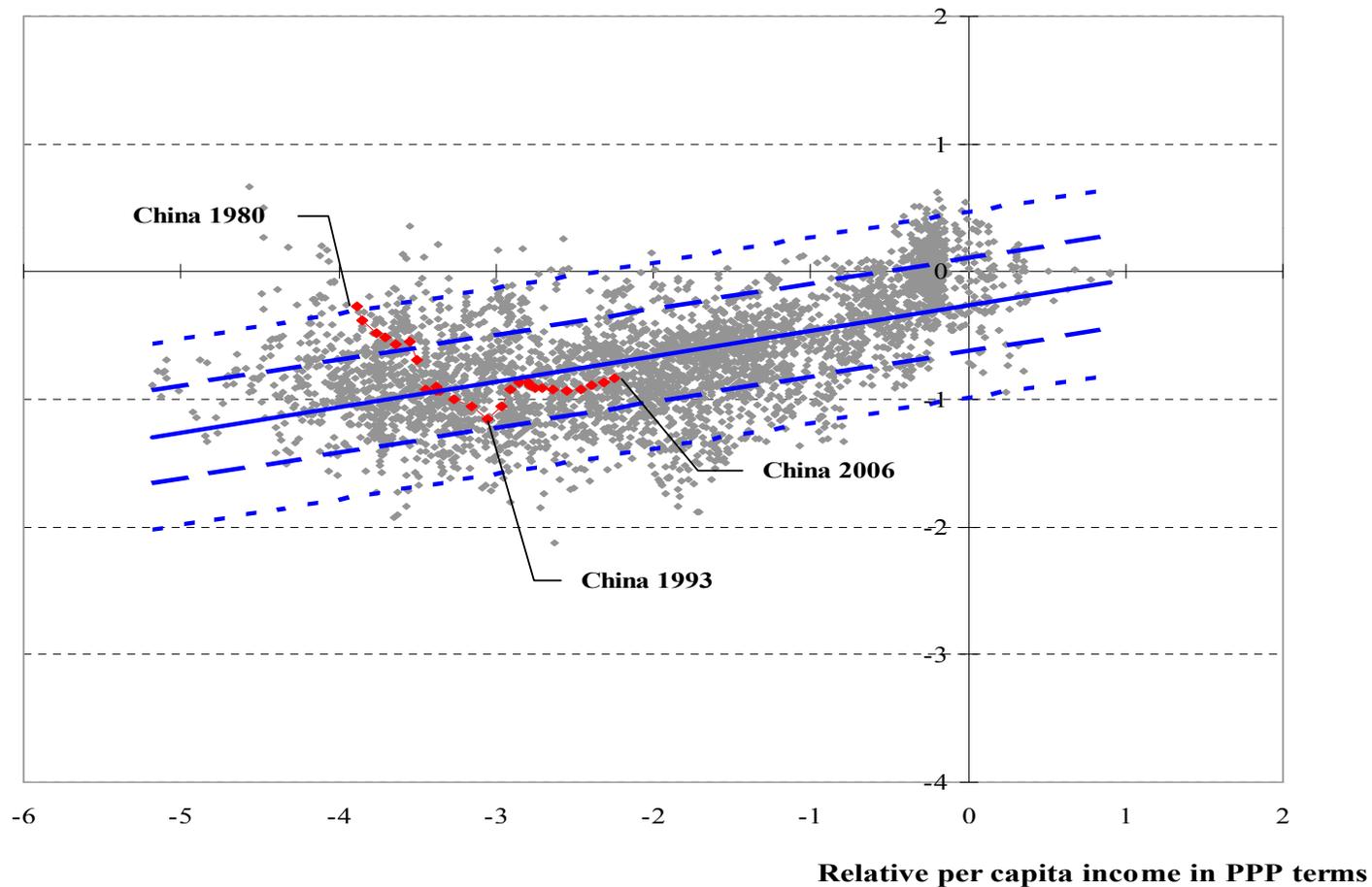
Relative price level



Source: Cheung, Chinn and Fujii (2010)

Price - income (PPP), 2008 vintage

Relative price level



Source: Cheung, Chinn and Fujii (2010)



Summary

- Clearly need for a re-think of current account and exchange rate assessment modeling
- Right track, but definite challenges
- Some are technical
- Some are economic/policy:
 - Can the approach address financial development issues?
 - Can it address int'l financial distortions