

Estimation of consistent multi-country FEERs

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NON-TECHNICAL SUMMARY

For years, the growing global imbalances between developed Anglo-Saxon countries and emerging Asian and oil-producing countries have motivated a large literature both dealing with causes and consequences. One of the most important issues is the threat of strong currency realignments, particularly for the dollar. Since the beginning of the economic crisis at the end of 2008, practitioners have wondered whether the ongoing process was going to close the imbalances and reduce the misalignment of the dollar or not.

In order to discuss this point, we develop a worldwide consistent fundamental equilibrium exchange rate (FEER) model. Methodological issues are important when estimating in the same model consistent equilibrium exchange rates for N countries or areas covering the whole world. First, the trade model has to be balanced at the aggregate level. This paper proposes a new method to achieve this both in volume and in value. Second, the $N - 1$ independent bilateral exchange rates cannot ensure that the N areas will reach their macroeconomic equilibrium. This paper examines the existing solutions to solve the $N - 1$ problem and proposes an alternative one which minimizes the distance to the current-account targets.

The recent economic crisis has strongly modified the assessment on output gap in many areas, namely in the US. Thus the dollar appears less overvalued than in previous estimations and the euro more overvalued. Despite the economic crisis, we observe no sign of a reduction in imbalances in Asian countries.

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