2009 Estimates of FEERs

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Updated Estimates

- Momentous changes in world economy over past year
- Dollar appreciated as perceived safe haven—but no influence (in principle) on FEERs
- Because a FEER is exchange rate that is indefinitely sustainable, therefore assumes normal capital flow (though this may be a range)
- FEERs are real and effective (trade-weighted)
- Oil and commodity prices fell
- Latest WEO as baseline (therefore average March exchange rates).

Assumptions

- What would happen in the absence of policy change
  - WEO modified by Cline forecast
  - Which foresees re-emergence of substantial US deficit if dollar stayed at March level
  - Hence we add to surpluses sums that in total equal the higher US non-oil deficit and are distributed in proportion to trade with the US
- Policies that ought to be pursued
  - Target current accounts the major case in point.

Current Account Targets

- Basic rule: imbalances should not be larger (in medium run) than 3% of GDP
- 3% rule-of-thumb is traditional, and has some statistical support
- New supplement this year: larger imbalances permitted to countries with large absolute NFA/GDP, provided that they do not threaten to increase |NFA/GDP| (derived from IMF Rule 3)
- Oil exporters excluded (neither assumptions re oil producers' saving strategies or the oil price forecasts deserve much credence).

Target Current Accounts for 2012

	IMF Forecast (% GDP)	Adjusted CA (% GDP)	Constant NFA/GDP (% GDP)	Target CA (% GDP)
Industrial Countries				
Canada	0.1	3.9	-0.4	3.2
Euro area	-0.7	-1.2	-0.6	-1.0
Japan	1.8	1.4	1.7	1.6
Switzerland	9.8	9.9	5.3	5.4
United Kingdom	-1.0	-0.7	-1.1	-0.5
United States	-3.4	-5.6	-1.0	-2.8
Developing Asia				
China	10.6	10.5	4.0	4.2
India	-2.8	-3.6	-0.9	-2.8
Korea	3.1	1.9	-1.7	2.1
Singapore	12.5	12.6	7.3	7.5

Misalignments

- Target CA changes are given by target CA (col 4) minus adjusted CA (col 2)
- Hence desired change in EER is target CA change/impact parameter
- Then Cline's SMIM is applied to get desirable change in dollar exchange rate.

Some Results of the Simulation

	Changes in CA (% GDP)		Change in REER (percent)		Dollar Exchange Rate		FEER-
	Target Change	Change in Simulation	Target Change	Change in Simulation	March 2009	Percentage Change	Equivalent dollar rate
Industrial Countries							
Canada	-0.7	-0.8	2.3	2.4	1.26	7.6	1.18
Euro area[a]	0.2	0.1	-1.2	-0.9	1.31	17.1	1.53
Japan	0.2	0.1	-1.5	-1.2	98	19.2	82
Switzerland	-4.5	-4.5	12.6	12.7	1.16	28.9	0.90
United Kingdom[a]	0.2	0.1	-0.7	-0.6	1.42	16.2	1.65
United States	2.8	2.7	-17.7	-17.4	1.00	0.0	1.00
Developing Asia							
China	-6.3	-6.4	21.2	21.4	6.84	40.2	4.88
India	0.7	0.7	-5.2	-4.9	51.1	14.2	44.8
Korea	0.2	0.1	-0.5	-0.3	1450	21.1	1197
Singapore	-5.1	-5.3	10.3	10.6	1.53	33.5	1.15

a. These countries have their currencies expressed as $ per currency. All other currencies are expressed as currency per $

Updating Simulation Results

	Recent Dollar Exchange Rates		
Country/Region	FEER equivalent	Average of May 26-June 2[a]	Change needed
Industrial Countries			
Canada	1.18	1.11	-6.2
Euro area[b]	1.53	1.40	9.0
Japan	82	95	16.4
Switzerland	0.90	1.08	19.8
United Kingdom[b]	1.65	1.61	2.7
United States	1.00	1.00	0.0
Developing Asia			
China	4.88	6.84	40.1
India	44.8	47.6	6.4
Korea	1197	1259	5.2
Singapore	1.15	1.45	25.9

a. All days but June 2nd are daily average; June 2nd is opening value

b. Dollars per currency unit

Conclusions

- US dollar had a renewed overvaluation in early 2009 when the IMF reported. Correction essential for sustained recovery. Half the increase has subsequently gone (despite Geithner’s talk of a strong dollar).
- Dollar is widely over-valued, but especially large re some Asian currencies.
- Increases in needed dollar rates far greater than increases in effective rates.
- US and China the only systemically important imbalances, hence the importance of China either pegging to a basket or crawling up against the dollar. (“More flexibility” is irrelevant, the critical issue is the rate.)