Discussion of “Concepts of Equilibrium Exchange Rates”
authored by R. Driver and P. Westaway at the
Second Workshop on Macroeconomic Policy Research

by
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Outline of my intervention

Two issues will be addressed:

• Explain why the paper “Concepts of Equilibrium Exchange Rates” offers a perspective to the issues relating to the estimation of a “fair” value of a currency

• Point to some empirical particularities relevant when applying the various concepts of equilibrium to acceding and accession countries’ currencies.
Concepts of Equilibrium Exchange rates 1

The paper is a comprehensive, intuitive and innovative survey of the literature.

Why?

• Time horizon important
• Derivation of a taxonomy of available methodological approaches to equilibrium exchange rate determination
Concepts of Equilibrium Exchange rates 2

Taxonomy allows for:

- a better understanding of the interrelationships between the various methodological approaches
- highlights the relevance of each approach in answering different types of questions
- clarifies that policy implications of an estimated "misalignment" would differ depending on the concept of equilibrium employed.
Empirical complications specific to ACs

Consider the most commonly used empirical approaches to equilibrium exchange rate determination

- Reduced form techniques (such as BEER)
- Normative Approaches (such as FEER)
Reduced form estimation techniques

Reliability of estimated relationship between exchange rate and fundamentals could be impaired.

Why?

• Small sample size
• Strong undervaluation at the start of transition
• Exchange rate policies
Normative techniques

Reliability of estimated trade elasticities, output gaps and sustainable current (capital) accounts adversely affected by:

• Short history of ACs as market economies
• Ongoing structural change
• Inadequate consideration of Balassa-Samuelson effects
What is the end result?

High probability of deriving unreliable estimates of the equilibrium exchange rate for ACs currencies.
Conclusion

• Take proper account of AC specific stylised facts and particularities
• Adopt a multi-approach stand to the estimation of the equilibrium exchange rate
• Cross check findings in terms of size and direction of estimated deviation from equilibrium
• Interpret findings with caution
The End