Comments on 'Exchange rate misalignment estimates – Sources of differences'

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What does the paper do?

- Assesses the effects of different data vintages and versions for estimates of equilibrium exchange rates; this is important because different data versions can give very different estimates of the equilibrium exchange rates

- Decomposes and explains part of the observed differences in the estimated equilibrium exchange rates

Equilibrium exchange rate

♦ In the paper equilibrium exchange rate is given by the Penn equation, where national price level (reciprocal of the PPP-based real exchange rate) is regressed on per capita income (in practice per capita GDP); the error term is then misalignment of the real exchange rate from its equilibrium value

♦ *Suggestion for a robustness check:* Is it possible to use GNP instead? For some countries the difference is large

It seems that..

♦ Differences across data revisions are larger for those countries that were not benchmark countries for ICP in 1993

♦ Differences across data revisions are larger for those countries that have poor data quality

♦ Differences across data revisions are larger for those countries that are initially poorer

♦ Even though these are not very surprising results, it is interesting to see that e.g. for China and India these factors explain much of the revision in the misalignment

♦ It is even more interesting that for some middle income countries these factors do not explain much!

Some thoughts about regressions

♦ Asymmetry taken into account by estimating regressions for positive and negative changes separately

♦ Is it possible that there non-linearities as well? (Perhaps the effect of initial income becomes less as income rises, for example?)

♦ Are there other economic factors that could be correlated with the observed differences? Perhaps the structure of the economy (share of services etc.)?

♦ While the Penn regression is appealing in its simplicity, could one try adding some more variables to the original regression? BEER approach of sorts? It would be interesting to see whether this changes anything

In closing…

♦ Important paper, and it could stress its own importance a bit more, given the political attention to the topic of equilibrium exchange rates

♦ What other estimates have been and will be affected by new estimates of relative price levels?