Comments on

The US Current Account and the Dollar

by Blanchard, Giavazzi, and Sa

Andrew K. Rose

UC Berkeley, CEPR and NBER

A fine paper!

- Good topic
- Nice model
    - Especially inclusion of valuation effects
- Reasonable assumptions
- Appropriate caveats

Bottom line eminently plausible

- Bearish on dollar
- Fiscal adjustment AND depreciation needed
- Going to the dentist sooner is easier than later

Of course …

- Ambitiousness necessarily implies vulnerability

Still,

- Most questions are small/technical/unimportant

Comments in Passing

- A paper seemingly written for/by US macroeconomists?
  - (exchange rate is not price of foreign exchange)

Is it Possible to Discuss these issues sensibly without Addressing Mystery #1?

- Why is long American interest rate so low and falling?

Doubts about Imperfect Asset Substitutability

- Good: Model works well in quantities
  - Home bias
- Bad: Model works poorly in prices
  - UIP deviations not linked empirically to shares/debt
  - A long history of failure, e.g., Frankel (1982)
  - Profession gave up on this in part because of evidence

Asset Preferences and Expected Long Run Depreciation

- Plausible to argue that asset preferences aren’t more affected by expected paths and history?
- Will foreign investors take slow, steady depreciation of their $ assets?
  - 56% (p 23) is a **large** number and exchange rates often move too much in short-run (for unknown reasons)
  - p13: key that American liabilities in $

Perhaps Not an Issue

- In practice, almost all movements to floating exchange rates unexpected
- Deterministic trends swamped in practice
- Includes big movements, which are sharp and usually unexpected (Figure 4)
- So trend may be there but very hard to detect

Bilateral Current Account Balances and Wealth

Reallocations

- Unusual to see bilateral accounts in macroeconomics
  - Usually only multilateral accounts matter
    - Solow’s barber
  - Financial intermediation through third countries irrelevant?

US Trade Deficit 2004

- BGS: $652 bn
    - half China ($160 bn)
    - one-quarter each: Euro area ($71bn), Japan ($75bn)
    - ignore half the deficit! ($346 bn)!

- **Data** (ERP Table 105):
    - $641 billion total
        - China $153 bn
        - Euro $84 bn
        - Japan $76 bn

But also

- Canada $69 bn
- Mexico $46bn

o Anti-North American bias!

More seriously, ignoring RoW means ignoring:

- "Fear of Floating"
- Countries with strong $ preferences
    - Latin America, E Asia all historically resist $ depreciation actively
    - Yen also actively managed from time to time (Ito)
    - More adjustment possible in $/Euro?

Dooley-Garber on Future

- India, Indonesia, etc. lining up if China’s “development through undervaluation” is successful

Bottom Line

- Thorough, reasonable paper HIGHLY worth reading
- Agree with major conclusions
- Especially conclusion that large $ depreciation not a catastrophe
  - Ditto loss of $ as anchor/reserve currency
    - Unlikely even in long run,
    - Not critical anyway (seigniorage small)