Comments on Berka and Devereux’s
What Determines European Real Exchange Rates?

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Summary

• Mostly an *empirical characterization* of European real exchange rates (RERs)
  – Also a theoretical model to rationalize key results

• Key: Valuable New Data Set
  – Prices, not indices, somewhat dis-aggregated
  – Many countries
Strong Results: 1

• Big Persistent differentials of RERs from PPP
  – These are *absolute* (not relative) PPP deviations
  – Bigger for flexible rate countries than fixers/EMU
  – Small EMU effect
  – Bigger for non-tradeables than tradeables
Strong Results: 2

• Strong Correlation of RERs with Real GDP ratios
  – Consistent with “Penn effect”/BS effect
  – 1% increase in relative GDP $\rightarrow$ .4% appreciation
    • Sensible, since more dispersion in GDP p/c than prices
  – Quantitatively large – explains *half* of individual RER variation
    – True across space *and time*: cross-section, time-series, panel (with FE)

• RERs positively correlated with relative non-tradeable/tradeable price
Frustrating Paper to Discuss

• All Bases Covered
  – Nice horse-race between theories

• Very careful data work
  – Ex: Prostitution is non-tradeable
  – Different Statistical Metrics for Deviation Size

• Emphasis on Persuasion
  – Figures as well as regression tables
  – Lots of Sensitivity Analysis
Conventional Wisdom Ratified

• Ex: Deviations from PPP big, persistent
  – Many, notably Engel and co-authors
  – But debate exists
    • Crucini et al: PPP works *well* dis-aggregated
    • Imbs et al: PPP deviations have *short* half-lives (≈18 m)
  – Thus data confirmation of CW a serious contribution

• Striking Consistency of Results
  – Usually data delivers more nuanced/muddied results
Still ... Data Set not Perfect

• Annual
  – Finer would be better, given PPP strikes back controversy

• Aggregation
  – Not very dis-aggregated; EIU is contrast
  – All consumer prices, so non-traded distribution component non-trivial
  – Thus no natural comparison (e.g., commodities where LOP holds well)

• Span
  – Some countries enter late
  – 15 years not much, given PPP-deviation half lives
Suggestions, 1

• Add trade barriers to list of alternative hypotheses in Table 3
  – Measure a la Leamer deviations (gravity model)
  – Unlikely to change much
  – Also, most usual suspects (institutions) sluggish over 15 years (institutions)

• What about the cyclic properties?
  – Markups are cyclic; what about the RERs here?
    • One small (2001), one large (great recession) downturn
Suggestions, 2

• Can twist data to use price deviations in gravity model to take account of more characteristics bilaterally?
  – Parsley and Wei Limiting Currency Volatility to Stimulate Goods Market Integration: A Price Based Approach

• Would like overwhelming confirmation of Mussa fact at micro level
  – Real $\approx$ Nominal exchange rate volatility
Suggestions, 3

• More serious model evaluation
  – Data evaluation much more rigorous than that of model
  – But model may not be that important
• Eventually: Need to make progress on causes for RER/y correlation at micro-level
  – Need more structure, data on productivity, wages, demand, etc.
Small Suggestions

• Add both country and time FE (table 3)
  – Also time FE in Table 5
  – Probably little effect

• Use dynamic panel model?

• Scale ordinate on figures similarly
  – Especially figure 4
Bottom Line

• Valuable Contribution to the Agenda

• But Plenty Remains!
  – Critically: *Why* the “Penn effect”?  
  – Would like reconciliation of where we stand
    • Many conflicting results demand “encompassing” explanation
    • Especially important given potential aggregation biases