

SM/01/152
Revision 1
Correction 1

August 23, 2001

To: Members of the Executive Board
From: The Secretary
Subject: **Methodology for Current Account and Exchange Rate Assessments**

The attached corrections to SM/01/152, Rev. 1 (8/20/01) have been provided by the staff:

Final two pages, item 5, line 1: for "(pp.19-20)" read "(pp. 24-25)"
line 3: for "page 5" read "page 7"
item 6, line 1: for "(pp. 26-30)" read "(pp. 30-34)"
item 8, line 1: for "(pp. 24-25)" read "(pp. 30-32)"
line 5: for "(pp. 26-28)" read "(pp. 32-34)"
item 9, line 1: for "p. 17" read "p. 22"
item 10, line 1: for "(pp. 11-15)" read "(pp. 14-20)"
line 3: for "p. 13" read "p. 16"
item 12, line 5: for "(pp. 21-22)" read "(pp. 27-28)"
line 6: for "(p. 22)" read "(p. 28)"

Questions may be referred to Mr. Isard (ext. 36640), Mr. Fetherston (ext. 38761), Mr. Kincaid (ext. 37356), and Mr. Faruqee (ext. 37332).

Att: (1)

Other Distribution:
Department Heads

Significant Changes to the Paper on CGER's Methodology for Current Account and Exchange Rate Assessments

Reorganization

1. The Executive Summary of SM/01/152 now appears (with appropriate editing) as the Summary (Section IV) of the revised paper, and the Concluding Remarks and Issues for Discussion from the Board paper have been dropped.
2. Annexes I and III of the Board paper appear as Annexes I and IV in the revised paper. Annex II of the Board paper has been dropped (see below).
3. Box 1 of the Board paper has been integrated with Annex II of the revised paper, which provides additional technical material on the RES model of current account adjustment and the benchmark WEO comparators.
4. Box 2 of the Board paper has been integrated with Annex III of the revised paper, which provides additional technical material on the industrial-country S-I model.

Editing of Sensitive or Inappropriate Material

5. Table 1 and the accompanying discussion (pp. ~~19-20~~ 24-25) no longer include specific country names; and the last sentence from paragraph 14 of the Board paper has been deleted from the corresponding paragraph on page ~~5~~ 7 of the revised paper. (This follows suggestions by Mr. Collins.)
6. The material on the methodology for emerging market economies (pp. ~~26-30~~ 30-34) has been trimmed and no longer includes paragraph 71, footnote 39, or Annex II of the Board paper.
7. References to internal documents have been deleted from the Introduction.

Clarifications in Response to Directors' Questions and Suggestions

8. In section III.A (pp. ~~24-25~~ 30-32) the second and third paragraphs (which replace paragraph 64 of the Board paper) have been rewritten to clarify the distinction between CGER's work on emerging market economies and the work on early warning systems. (This responds to Mr. Toyama's request.) In the discussion of sustainability criteria in section III.B (pp. ~~26-28~~ 32-34), references to the 40 percent threshold and 10-year historical average have been replaced by more general descriptions of these types of criteria, and a few sentences have been added in light of various analytical points made by Directors (including by Mr. Portugal and Mr. Junguito in their gray).

9. Three paragraphs have been added (starting with the first complete paragraph on p.~~17~~22) to explain how tax cuts and productivity shocks affect the equilibrium exchange rate. (This responds to questions from Mr. Josz and Mr. Abbott.)

10. The section on saving-investment norms (pp.~~11-15~~14-20) has been rearranged somewhat and includes two additional paragraphs (beginning with the first complete paragraph on p.~~13~~16) aimed at clarifying the interpretation and limitations of the S-I equation.

11. Footnotes 26 and 32 have been added to explain how the methodology was modified to incorporate the Euro Area, and to indicate how much the methodological change affected the quantitative assessments. (This responds to questions from Mr. Abbott, Mr. Wei, and Mr. Kapteyn.)

12. The paper has been elaborated or clarified in several places to provide a more explicit sense of the role that judgment has played in CGER's assessments. (This responds in spirit to Mr. Chelsky's request for examples that illustrate the importance of balancing the quantitative analysis and judgment.) The changes included: a revision of the three paragraphs in Section II.C (pp.~~21-22~~27-28); the addition of the first two paragraphs in Section II.D (p.~~22~~28); and the addition of footnote 29 (which also provides some sensitivity analysis in response to the interest expressed by Mr. Collins).

13. Footnote 35 has been added to elaborate on how the global discrepancy affects the calculations (in response to a question from Mr. Kapteyn).

Other Changes

14. Footnotes 17, 23, and 36 have been added.